SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY, APPELLANT,

vs.

WISCONSIN DEPARTMENT OF TAXATION

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN

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[fol. 1]

IN THE SUPREME COURT OF THE UNITED STATES

INTERNATIONAL HARVESTER COMPANY, Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Appellee.

ORDER ALLOWING APPEAL AND FIXING AND APPROVING BOND—
Filed December 11, 1943

The petition of International Harvester Company, the above named Appellant, for an allowance of an appeal to the Supreme Court of the United States from the Supreme Court of the State of Wisconsin having this day been filed, and there having been presented and filed assignments of error, prayer for reversal and statement as to jurisdiction, pursuant to the statutes and to the rules of the Supreme Court of the United States in such case made and provided;

It is ordered that an appeal be and the same is hereby allowed to the Supreme Court of the United States from the Supreme Court of the State of Wisconsin in the above entitled cause as provided by law, and the Clerk of the Supreme Court of the State of Wisconsin shall prepare and certify a transcript of the record and proceedings in the above entitled cause to the Supreme Court of the United States, so that the transcript shall be filed with the Court within forty (40) days from the date hereof.

It is further ordered that security for costs on the appeal be fixed in the sum of $1,000.00, bond for which with Fidelity and Deposit Company of Maryland as surety is now presented by Appellant, is approved, and is ordered filed.

[fol. 2] Entered at Madison, Wisconsin, this 11th day of December, 1943.

Marvin B. Rosenberry, Chief Justice of the Supreme Court of the State of Wisconsin. (Seal.)

[fol. 3] [File endorsement omitted.]

[fol. 4] IN THE SUPREME COURT OF THE UNITED STATES

[Title omitted]

PETITION FOR ALLOWANCE OF APPEAL, ASSIGNMENTS OF ERROR AND PRAYER FOR REVERSAL—Filed December 11, 1943

International Harvester Company, the above named Appellant, being aggrieved by the decision and judgment of the Supreme Court of the State of Wisconsin rendered in the above entitled cause on June 16, 1943, and its denial on September 14, 1943 of Appellant's motion for rehearing thereof, which decision and judgment affirmed the judgment of the Circuit Court for Dane County, Wisconsin, in turn affirming a certain assessment of taxes made by Wisconsin Department of Taxation, and sustained the validity of the law (Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937) under which said tax assessment was made, notwithstanding there was drawn in question the constitutionality of said law and the assessment thereunder as applied to Appellant under the Fourteenth Amendment of the Constitution of the United States, hereby prays that an appeal by this Appellant be allowed herein to the Supreme Court of the United States to the end that said decision and judgment of the Supreme Court of Wisconsin may be there reviewed and considered and justice done this Appellant; and that an order be made fixing the amount of bond required of Appellant herein on such appeal.

[fol. 5] In support of this petition for appeal Appellant assigns the following errors in the record and proceedings in said cause:

(1) The Supreme Court of Wisconsin erred in failing to hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, as applied to International Harvester Company, a New Jersey corporation, and its stockholders, especially the non-residents of Wisconsin, under the undisputed facts of the case, was invalid because in effect an imposition of a tax on transactions beyond the State's jurisdiction and hence repugnant to the Fourteenth Amendment of the Constitution of the United States.

(2) The Supreme Court of Wisconsin erred in failing to hold that the assessments of taxes involved in this matter,

purporting to have been made in pursuance of the provisions of Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, against International Harvester Company, a New Jersey corporation, under the undisputed facts, operated to take the property of Appellant and of its stockholders, especially the non-residents of Wisconsin, without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

(3) The Supreme Court of Wisconsin erred in failing affirmatively to determine and hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, and the assessments of taxes thereunder against Appellant, insofar as the same operated or were applied to tax the distribution of income or profits of Appellant derived and accumulated prior to the enactment of that law, deprived Appellant and its stockholders of property without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

[fol. 6] For these errors the said Appellant prays that the judgment of the Supreme Court of Wisconsin be reversed and judgment directed granting to Appellant the relief prayed for in its appeal to the Supreme Court of the State of Wisconsin in respect to the tax assessment complained of.

John A. Kratz, 1001 Fifteenth St., N. W., Washington, D. C., Edward R. Lewis, 180 N. Michigan Ave., Chicago, Ill., Ray M. Stroud, 1 W. Main St., Madison, Wis., Attorneys for Appellant. Stroud, Stebbins & Wingert, of Counsel.

[fol. 7] [File endorsement omitted.]

[fol. 8] IN THE SUPREME COURT OF THE UNITED STATES

[Title omitted]

ASSIGNMENT OF ERRORS—Filed December 11, 1943

Appellant, International Harvester Company, in support of its petition for appeal to the Supreme Court of the United States in the above entitled cause, hereby assigns

the following errors in the record and proceedings in said matter:

(1) The Supreme Court of Wisconsin erred in failing to hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, as applied to International Harvester Company, a New Jersey corporation, and its stockholders, especially the non-residents of Wisconsin, under the undisputed facts of the case, was invalid because in effect an imposition of a tax on transactions beyond the State's jurisdiction and hence repugnant to the Fourteenth Amendment of the Constitution of the United States.

(2) The Supreme Court of Wisconsin erred in failing to hold that the assessments of taxes involved in this matter, purporting to have been made in pursuance of the provisions of Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, against International Harvester Company, a New Jersey corporation, under the undisputed facts, operated to take the property of Appellant and of its stockholders, especially the non-residents of Wisconsin, [fol. 9] without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

(3) The Supreme Court of Wisconsin erred in failing affirmatively to determine and hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, and the assessments of taxes thereunder against Appellant, insofar as the same operated or were applied to tax the distribution of income or profits of Appellant derived and accumulated prior to the enactment of that law, deprived Appellant and its stockholders of property without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

John A. Kratz, 1001 Fifteenth St., N. W., Washington, D. C.; Edward R. Lewis, 180 N. Michigan Ave., Chicago, Illinois; Ray M. Stroud, 1 W. Main St., Madison, Wisconsin, Attorneys for Appellant.

Stroud, Stebbins & Wingert, of Counsel.

[fols. 10-103] [File endorsement omitted.]

[fol. 104] IN THE SUPREME COURT OF THE UNITED STATES

[Title omitted]

PRAECIPE INDICATING PORTIONS OF RECORD TO BE INCORPORATED INTO THE TRANSCRIPT—Filed December 27, 1943

To the Clerk of the Supreme Court of the State of Wisconsin:

In conjunction with Appellant's appeal to the United States Supreme Court in the above entitled cause, in which Order Allowing Appeal was issued December 13, 1943, and on the same date filed with you, you are hereby requested to prepare, certify and transmit as part of the transcript to the Clerk of the United States Supreme Court, in accordance with the requirements of statute and of the rules of that Court, the following:

1. Testimony of Herbert Kuentz before Wisconsin Board of Tax Appeals, appearing at Record pages 28 to 37; and transcript of continuation of hearing before said Board appearing at Record pages 40 to 44.

2. Testimony of Charles L. Johns appearing at Record page 46, being the first three questions and answers on direct examination, and on cross-examination at Record pages 48 and 49.

3. Stipulation of Facts, being Exhibit 6, on hearing before Wisconsin Board of Tax Appeals, Record pages 72-75.

4. "Recomputation of liability for additional Wisconsin prvilege dividend taxes computed in accordance with percentage of surplus method ordered by Wisconsin Supreme Court in *J. C. Penney Co. v. Department of Taxation*, 298 N. W. 186", being Exhibit 7, on hearing before Wisconsin Board of Tax Appeals, Record pages 76-86.

[fol. 105] 5. Stipulation before Wisconsin Board of Tax Appeals, including "Computation of Wisconsin dividend taxes in accordance with percentage of surplus method ordered by Wisconsin Supreme Court in *J. C. Penney Co. v. Department of Taxation*, 298 N. W., 186, and on basis of an analysis of the *separate* surplus of International Harvester Company", being Exhibit 7A, of hearing before Wisconsin Board of Tax Appeals, Record pages 88-95.

6. Supplementary stipulation of facts before Wisconsin Board of Tax Appeals, Record page 111.

7. Decision and Order of Board of Tax Appeals, Record pages 121-127.

8. Appeal to Circuit Court for Dane County, Wisconsin, Record pages 1-8 (omitting Exhibit "A" thereto, being copy of Decision and Order of Board of Tax Appeals called for above).

9. Decision of Hon. Alvin C. Reis, Judge, in Circuit Court for Dane County, Record pages 127-137.

10. Judgment of Circuit Court for Dane County, Record pages 141-143.

11. Appeal to Wisconsin Supreme Court, Record page 145 (omitting Exhibit "A" and Exhibit "B" thereto, being copy of Order and Judgment of Circuit Court for Dane County and the latter being called for above).

12. Excerpts from Appellant's brief in the Supreme Court of Wisconsin as follows:

Proposition "II" at page 30.
Proposition "III" at page 33.
Proposition "IV" at page 38.
Proposition "V" at page 40.

13. Decision and Judgment of Wisconsin Supreme Court dated June 16, 1943.

14. Appellant's Motion for Rehearing in Wisconsin Supreme Court filed July 3, 1943.

[fol. 106] 15. Excerpts from Appellant's brief in support of Motion for Rehearing in Supreme Court of Wisconsin as follows:

Heading appearing at page 1.
Heading "B" at page 10.
Heading at page 11.
Heading at page 16.

16. Decision and Judgment of Wisconsin Supreme Court on Motion for Rehearing dated Sept. 14, 1943.

17. Petition for allowance of appeal to United States Supreme Court, Assignment of Errors and Prayer for Reversal, filed December 11, 1943.

18. Assignment of Errors of Wisconsin Supreme Court filed December 11, 1943.

19. Statement as to Jurisdiction of United States Supreme Court, filed December 11, 1943.

20. Appellant's Appeal Bond filed December 11, 1943.

21. Order allowing appeal to United States Supreme Court, fixing and approving bond, dated and filed December 11, 1943.

22. Citation to Appellee on appeal to United States Supreme Court dated December 11, 1943.

23. Service of Appeal papers on Appellee and statement directing Appellee's attention to paragraph 3 of Rule 12 of Rules of Supreme Court of the United States, filed December 13, 1943.

24. Affidavit of service of appeal papers and Citation on Appellee, dated and filed December 13, 1943.

25. This Praecipe indicating portions of record to be incorporated into the transcript, dated and service acknowledged December 17, 1943.

Dated this 17th day of December, 1943.

John A. Kratz, Edward R. Lewis, Ray M. Stroud,
Attorneys for Appellant.

[fol. 107] Due service of the foregoing Praecipe this 17th day of December, 1943, is hereby acknowledged.

John E. Martin, Attorney General of Wisconsin, by
H. H. Persons, Asst. Atty. General, Attorney for
Wisconsin Department of Taxation.

[fol. 107a] [File endorsement omitted.]

[fol. 108] [Caption omitted]

[fol. 109] In Circuit Court for Dane County

International Harvester Company, Petitioner and Appellant,

vs.

Wisconsin Department of Taxation, Respondent

Notice of Appeal to Supreme Court

Please Take Notice that the petitioner above named hereby appeals to the Supreme Court of the State of Wis-

consin from the order of the Circuit Court for Dane County, dated the 17th day of September, 1942, in the above entitled matter, and from the judgment in the above entitled matter dated and entered on the 17th day of September, 1942, affirming an additional assessment of privilege dividend taxes against the above named petitioner, this appeal being from the whole of such order and from the whole of such judgment. Copy of such order and of such judgment are hereto attached and marked, respectively, Exhibit "A" and Exhibit "B".

Dated this 14th day of October, 1942.

R. M. Stroud, Edward R. Lewis, Attorneys for International Harvester Company.

To Wisconsin Department of Taxation; John E. Martin, Esq., Attorney General of the State of Wisconsin; Harold H. Persons, Assistant Attorney General of the State of Wisconsin; Clerk of Circuit Court for Dane County, Wisconsin.

[fol. 110] Before the Board of Tax Appeals of Wisconsin

Testimony of Herbert Kuentz

Whereupon Herbert Kuentz, being first duly sworn, testified as follows:

By Mr. Teschner:

Q. Mr. Kuentz, will you state your full name for the record?

A. Herbert D. Kuentz.

Q. And what is your status with the department of taxation?

A. Chief accountant in the income tax division.

Q. And you are a certified public accountant also?

[fol. 111] A. Yes sir.

Q. And how long have you been with the department of taxation?

A. About twenty-four years.

Q. And how many of those years were you chief accountant approximately?

A. About eight.

Q. And do you have supervision of the field audits made by the corporation field auditors in income and privilege dividend tax cases?

A. Yes.

Q. And do you review each one of those reports submitted by those auditors?

A. Not each one.

Q. But substantially all?

A. I review all on which there is any controversy.

Q. I see, and Mr. Kuentz, are you familiar with the recomputation of the privilege dividend tax liability after the Penney decision in the present case?

A. I am.

Q. And I show you Exhibit 7 and ask you if that is a copy of the recomputation made by Mr. Michlar under your direction and supervision?

A. Yes, it is.

Q. And will you look at these work sheets and see if that is the original report prepared by Mr. Michlar, of which Exhibit 7 is an exact copy?

A. Yes, it is.

Q. Would you please explain to the board of tax appeals and for the record how you recomputed the privilege divi- [fol. 112] dend tax liability, that is, under your interpretation of the supreme court's mandate in the J. C. Penney case, and will you please start from the beginning.

A. Probably the members of the board would want a copy of this so that they could understand.

Q. Yes, I will give them a copy—I am sorry. First, Mr. Kuentz, you might point out the actual computation and compare it with the original computation. That would be page one of this exhibit, would it not?

A. Yes, the net result of the additional privilege dividend taxes on the basis of this revised computation is shown in Exhibit A of Exhibit 7, page 1, and is $62,446.63, exclusive of penalty and interest.

Q. And it is correct, is it not, Mr. Kuentz, to say that the dividends in question in this period were paid from accumulated surplus?

A. We have so construed it, yes.

Q. Yes, after our stipulation and therefore it was necessary to determine the per cent of Wisconsin surplus that went to make up each dividend payment.

A. Yes sir.

Q. And that you did on Exhibit B, which commences on page two of the particular report you are examining now. Is that correct?

A. That is correct.

Q. And now, I notice that you start with a balance on January 1, 1928. Why is that?

A. The reason that we didn't go back of January 1, 1928 to analyze this surplus is that the entire surplus as of that date was dissipated by charges during that year. The sur- [fol. 113] plus as of January 1, 1928, shown by the tax returns filed by the corporation, amounted to $68,255,323.16. During the year 1928 there was transferred from this surplus to the capital stock account $66,137,770. It is my understanding that this transfer from surplus to capital stock was made in connection with a change in the capital structure, the common stock of one hundred dollars par value being changed to four shares of no par value. In addition, there were dividends paid in the year 1928 of some seventeen odd million of which $2,117,553.16 go to dissipate the balance of that opening surplus.

Now then, the income for the year 1928, the book income as shown by the tax return filed by the corporation is $21,394,298.41. Of that amount we have assigned 5.93587% to Wisconsin, or an amount of $1,269,937.72. That per cent was obtained as is shown in schedule 1 on page 4, as follows: The total taxable income of the corporation for the year 1928 was $48,381,125.12. The portion taxable by the state of Wisconsin was $2,871,841.03. The ratio of the taxable portion to the total is the 5.93587%, which on Exhibit B we applied to the book income.

Now then, by addition and subtraction we arrive at the balance of surplus as of December 31, 1928, the total being six odd million, the Wisconsin portion $384,709.62, and the portion allocated outside Wisconsin $6,096,389.83. There also the ratio of the Wisconsin portion to the total is 5.93587%.

The book income for 1929 was allocated between Wisconsin and outside of Wisconsin in the same manner as I described for the income of the year 1928. The dividends paid [fol. 114] during the year 1929 were first charged against the balance of surplus as of December 31st, 1928, and the six million, 481 thousand was entirely dissipated. The balance of the dividends paid in 1929, nine million, 984 thousand odd, were then charged against the income for the year 1929, the only remaining source from which dividends could be paid. And they were charged—they were allocated against that income on the same ratio, 6.13689, which is the percentage of Wisconsin 1929 income to the total income.

Likewise, the 1930 income was prorated between Wisconsin and the total on the same basis in the same manner as the 1928 income was allocated, and the 1930 dividends paid were charged against the surplus balance as of January 1, 1930.

Coming down to the 1931 income, you will observe that this income is divided into two parts, first the income of those companies which were included in the Wisconsin consolidation and then the income or loss of those companies which were excluded from the Wisconsin consolidation. The income included—the book income included in the Wisconsin consolidation amounted to $9,190,235.47. This was prorated between Wisconsin and outside of Wisconsin as is shown on schedule 4. The book income included in the Wisconsin consolidation was reduced by the non apportionable income which had its situs outside the state of Wisconsin, the amount being $1,915,728.80, leaving a balance of apportionable income of the companies included in the Wisconsin consolidation of $7,274,506.67. Of this amount 7.80922% was allocated to Wisconsin. This is the percentage of allocation determined in the tax commission's 1931 to 1936 income tax audit report, making an amount al- [fol. 115] located to Wisconsin of $668,082.22, which is 6.18136 per cent of the total book income.

Then turning back again to Exhibit B, the loss of the steel department and other companies not included in the Wisconsin consolidation, being $4,950,670.11, was entirely charged against the surplus allocated to outside of the state of Wisconsin. The dividends paid in 1931 were again charged against the balance of surplus as of January 1, 1931, in the same ratio that the Wisconsin surplus bore to the total surplus.

In 1931 there was transferred from certain sundry contingent reserves to the surplus account an amount of eleven million dollars. In this report this eleven million dollars was prorated as between Wisconsin and outside of Wisconsin in the same ratio as the surplus for Wisconsin bears to the total surplus on January 1, 1931.

Mr. Stroud: Just so that I may avoid cross examination, I wonder whether you would explain whether the contingent reserves, the amount of the contingent reserves, eleven million dollars, where that came from, and whether that should be apportioned within and without Wisconsin on that same percentage basis.

Witness: The eleven million dollars consists of certain reserves that were set up for contingencies but which were not deducted for income tax purposes. They were, however, deducted in order to determine the book income, and for that reason they have been restored on the same ratio we have in the surplus as of the beginning of the year.

Then proceeding to 1932, there again the income is divided into two parts and with the same explanation as I have [fol. 116] given in 1931—for the year 1931. In this case they are both losses. The loss of the companies included in the Wisconsin consolidation amounted to $3,079,761.15. This was prorated between Wisconsin and the total as is shown. The reference states schedule 1, but schedule 1 again refers back to schedule 3 so that you will have to turn to schedule 3 to get the proration of the loss for that year. The total net loss for income tax purposes was $14,147,751.83. From this is deducted the non apportionable income of $1,447,000 odd, leaving an apportionable net loss of $15,595,109.91. There was no apportionment data submitted with the 1932 tax return, possibly for the reason that there was none required because it wasn't necessary to prorate a taxable loss nor was there any apportionment data computed in our audit report covering that year, so that in order to prorate this loss, we took the average of the apportionment percentages for the years 1928, 1929, and 1930, which percentages were complete in the returns filed by the corporation and in our audit reports. The average of those percentages amounting to 6.13643 was applied to the fifteen million odd loss, giving a Wisconsin taxable loss of $956,982.94.

Now, following that under schedule 1, the 956 odd thousand compared with the total net loss of fourteen odd million results in a percentage for Wisconsin of 6.76420, which is the percentage used on Exhibit B.

The dividends for the year 1932 were again charged to surplus in the same ratio as the surplus balance at the beginning of the year. Likewise a transfer from contingent [fol. 117] reserves to surplus of ten million in 1932 was again prorated between Wisconsin and outside of Wisconsin at the ratio of the surplus balances at the beginning of that year.

Coming then down to the income for the year 1933, that was again divided as between the companies in the Wisconsin consolidation and those outside of the Wisconsin con-

solidation. The companies in the Wisconsin consolidation, the book income was prorated as is shown on schedule 4, page 7. The total book income for the year 1933 was $4,908,228.51. Deducting the non apportionable income of $8,948,479.01, leaves an apportionable book income of $959,749.50. Of this 7.84059 per cent was allocated to Wisconsin. That percentage was determined as is shown in schedule 5 and represents the average of the per cent of Wisconsin tangible assets to the total, the per cent of Wisconsin cost of manufacturing to the total, but the sales for Wisconsin were not shown in that year either on the tax return or in the department's audit report, so that for the sales percentage we used the average for the years 1934, 1935, and 1936, which average per cent is 3.22179, and the average of the three percentages as stated before, is 7.84059, making a book income apportioned to Wisconsin of $75,250.02 or 1.53314 per cent of the total book income.

The transfer to surplus from contingent reserves of ten million dollars in 1933 was handled in the same manner as described for the years 1931 and 1932. Likewise the dividends paid for 1933 were charged against surplus in the same ratio as the surplus balances at January 1, 1933.

The 1934 income of the companies included in the Wis- [fol. 118] consin consolidation was prorated in the same manner as explained for the years 1928 and 1929. Likewise the dividends paid for 1934 were charged on the basis of the ratio of the opening surplus balances.

Turning then to page 3, the 1935 income was again prorated between Wisconsin and outside of Wisconsin on the same basis as described for 1928 and 1929. The dividends for 1935 were charged against the opening surplus balances in the ratio of the surplus balances as of the beginning of the year. The same explanation applies for the income of 1936, the transfer of reserves in 1936 and the dividends paid in 1936 as has been given in previous years.

Q. Now, Mr. Kuentz, would you tie that up with Exhibit A as to the dividends that are actually taxable?

A. Yes. In Exhibit A there are shown one dividend paid in the year 1935, that is subject to the privilege dividend tax and that is the dividend paid on December 2, 1935. The portion of that dividend attributable to Wisconsin is obtained from the ratio of the surplus balances as of December 31, 1934, as shown on page 3 of Exhibit B, or 5.78469

per cent. The dividends paid during the year 1936 up to and including the dividend of October 15, 1936, the portion of those dividends attributable to Wisconsin are computed on the basis of the surplus ratio as shown in Exhibit B, as of December 31, 1935, or 6.12580 per cent. The one remaining dividend in 1936 is computed—the Wisconsin portion is computed on the basis of the ratio as of October 31, 1936, for the reason that the company at that time changed its fiscal year from a calendar year to October 31st, fiscal year. And all of the dividends for the year 1937 including—up to and [fol. 119] including the dividend paid October 15th, 1937, the portion of those dividends attributable to the state of Wisconsin are computed at the percentage of the Wisconsin surplus to total surplus as shown on Exhibit B as of October 31, 1936, or 6.61902 per cent.

Mr. Teschner: All right, Mr. Kuentz, that is all. Thank you.

[fol. 120] COLLOQUY

Mr. Broadfoot: This is a continuation of the hearing of the International Harvester Company, petitioner, vs. the Wisconsin Department of Taxation, respondent, that was held before the board on September 23rd, 1941, adjourned to this date by stipulation of the parties.

Mr. Teschner: May it please the board, at the close of the last hearing in this matter, the respondent introduced in evidence a recomputation of Wisconsin privilege dividend tax liability of the petitioner corporation. That computation was the first one that the petitioner had seen and it requested the right to check and examine the recomputation. That was done, and after some correspondence and a conference, a revised further recomputation was agreed upon, and a stipulation has been drawn with respect to that particular revised recomputation and that will — intro- [fol. 121] duced in evidence here this afternoon.

Before proceeding with that matter, there are three slight errors in the transcript of the hearing held heretofore, and with the board's permission we would like now to make those corrections.

On page 7 of the transcript, the second question from the bottom should read "And will you look at these work sheets and see if that is the original report prepared by Mr. Michlar". The word "prepared" being substituted for

the word "presented". I understand that Mr. Stroud has no objection to that change being made.

Then on page 8 of the transcript—these changes are just minor, they don't affect the substance—there should be a comma after the word "liability" in the first line, the word "what" should be "that", and there should be a comma after "is", and then the word "under" should appear before the word "your", and the correction is made. So that it reads, "tax liability, that is, under your interpretation of the supreme court's mandate".

Then the only other change is on page 11, in the first full paragraph on that page, in the last sentence of the paragraph, the word "income" should be changed to "surplus", so that that sentence reads "The dividends paid in 1931 were again charged against the balance of surplus as of January 1, 1931, in the same ratio that the Wisconsin surplus bore to the total surplus". Those are the only corrections.

The Chairman: Are those changes satisfactory, Mr. Stroud?

Mr. Stroud: Yes.

Mr. Teschner: I would now like to have marked as Ex- [fol. 122] hibit 7 A a computation of Wisconsin privilege dividend taxes, based upon the precentage of surplus method ordered by the supreme court in the J. C. Penney case, and upon a basis of an analysis of a separate surplus of the International Harvester Company, together with a stipulation with respect to said recomputation.

Mr. Stroud: No objection to that offer, except I take it that we do not concede that this computation is in accordance with the percentage of surplus method ordered by the Wisconsin supreme court in the Penney case.

Mr. Teschner: Well, the stipulation explains that.

Mr. Stroud: It speaks for itself.

Mr. Teschner: That is right, it speaks for itself and it is clear.

(Discussion off the record.)

The Chairman: Have you offered Exhibit 7-A in evidence?

Mr. Teschner: I am going to call Mr. Kuentz in reference to that before offering it.

HERBERT KUENTZ, having been heretofore duly sworn, recalled, testified as follows:

Q. Mr. Kuentz, you are the same Herbert Kuentz who testified at a previous hearing on this matter, on September 23rd, are you?

A. I am.

Q. And I would like to show you Exhibit 7-A and ask you to refer to that part labelled "computation" and, did you prepare Exhibit 7-A insofar as the computation is concerned?

A. Well, I think it is more correctly stated if you refer only to Exhibit A or the entire——

Q. I refer to the entire computation of 7-A, everything ex- [fol. 123] cept the stipulation.

A. That was originally prepared by the taxpayer and submitted to us at a conference.

Q. And you have checked it?

A. I have had the entire exhibit checked, yes.

Q. And did the petitioner furnish you with a proposed revision of Exhibit 7 in this case?

A. Yes, that is 7-A is the proposed revision of 7.

Q. And 7-A has been accepted by the department as setting forth the correct computation of privilege dividend taxes under the method used by the department?

A. That is correct.

Q. In what respects does the computation in Exhibit 7-A differ from that in Exhibit 7 heretofore introduced?

A. The major difference between Exhibit 7 and 7-A is that in 7 the surplus analysis includes a consolidated surplus of International Harvester Company and a number of its affiliated companies, whereas the analysis in 7-A is of International Harvester Company alone. It is the separate surplus of International Harvester Company.

The second major difference is probably the starting point. In Exhibit 7 surplus analysis began with the balance on January 1, 1928, whereas in Exhibit 7-A the surplus analysis so far as it is used in this computation, begins with January 1, 1931. The reason for that is that the—in taking the separate surplus of International Harvester Company it was not necessary to go beyond January 1, 1931, because at that point the company had a deficit, and the entire surplus had been dissipated. Perhaps one other major differ- [fol. 124] ence can be pointed out in Exhibit B-1 of 7-A, that

is on page three, there were a number of years in which International Harvester Company took on to its books the increase in value of the subsidiary companies. In this exhibit that surplus transferred from the subsidiaries to International Harvester in those years has been eliminated, so that we wind up with the separate surplus of International Harvester Company alone.

Mr. Conway: By this exhibit, what do you refer to, give us the number.

A. Exhibit 7-A, page 3, sub Exhibit B-1. There are other minor differences in the method of computing the Wisconsin taxable income.

Q. But those differences only related to the determination of Wisconsin income. Is that not correct?

A. Yes, and I think they are self-explanatory in this Exhibit 7-A.

Q. Yes. Then you won't need to explain them, Mr. Kuentz. The amount of tax exclusive of penalty and interest, is that shown on schedule A of Exhibit 7-A?

A. Yes, it is.

Q. How does that compare with the tax computed in Exhibit 7?

A. The additional privilege dividend taxes for the entire period on Exhibit 7 is $62,446.63. The amount of additional taxes on 7-A is $53,713.29.

Mr. Teschner: That is all, Mr. Kuentz. You may cross examine.

Mr. Stroud: No examination.

Mr. Teschner: We now offer Exhibit 7 A in evidence.

[fol. 125] Testimony of Charles L. Johns

CHARLES L. JOHNS, having been first duly sworn, testified as follows:

Mr. Stroud:

Q. Will you state for the record your name Mr. Johns?

A. Charles L. Johns.

Q. What is your position with the International Harvestor Company?

A. I am the auditor of tax, in charge of tax returns.

Q. And you have been with the company how long?

A. I have been with the company for thirty years, little more than thirty years.

[fol. 126] Cross Examination of Charles L. Johns

Q. Mr. Johns, are you familiar with the manner in which the earnings of the International Harvester Company are handled?

A. Yes, sir.

Q. Mr. Johns, I would like to read you from the supreme court decision, the Wisconsin supreme court decision in the J. C. Penney case that was most recently decided by that court, I am quoting: "The earnings are handled according to ordinary business practice. They are not earmarked or segregated or manipulated in any manner whatever". That is the end of the quotation. I now ask you, Mr. Johns, whether that statement is true with respect to International Harvester Company, the petitioner here?

A. Yes sir, I would say it is. We don't earmark any of [fol. 127] our earnings that go directly to surplus account.

Q. And they and hendled according to ordinary business practices?

A. That is correct.

Mr. Teschner: That is all, Mr. Johns.

[fol. 128] Exhibit 6

In Re: Privilege Dividend Tax Apepal—International Harvester Company vs. Wisconsin Department of Taxation

Docket D-5

Stipulation of Facts

The parties hereto stipulate that the following are facts and that this Stipulation may be received as evidence thereof, Petitioner being hereby relieved of the necessity of making formal proof thereof; that, however, Respondent does not hereby waive its right to object to the materiality or relevancy of such evidence to the issues in this appeal.

(1) The International Harvester Company is a corporation organized September 19, 1918, under the laws of the State of New Jersey. Its principal office is in Hoboken, New Jersey. During the entire period since September 26, 1935, when the Wisconsin Privilege Dividend Tax be-

came effective, the general offices of the International Harvester Company have been located, until October 31, 1937 at 606 South Michigan Avenue, and since then at 180 North Michigan Avenue, Chicago, Illinois.

(2) The International Harvester Company is admitted to do business in every state of the United States except Nevada, and has been so admitted since January 1, 1936. Until December 31, 1935, the products manufactured by the International Harvester Company were distributed in the United States by the International Harvester Company of America, a Wisconsin corporation, all of whose capital stock was owned or controlled by the International Harvester Company, and the International Harvester Company of America operated all the selling branches in Wisconsin and the rest of the United States. Since 1920 the International Harvester Company has had manufacturing plants in Illinois, Indiana, New York, Tennessee, Ohio, Louisiana and in Milwaukee, Wisconsin. It has more than 100 selling branches in the United States. In the State of Wisconsin it has selling branches in Milwaukee, Madison, Eau Claire and Green Bay. After December 31, 1935, except in Wisconsin, said products manufactured by the International Harvester Company were distributed by the branches of the International Harvester Company, and since October 31, 1939, all the branches in the United States have been owned and operated by the International Harvester Company. In the last fifteen years there have been more than 100 selling branches in the United States.

(3) The executive offices of the International Harvester Company are located at its general offices in Chicago, Illinois. The heads of its various departments, Executive, Manufacturing, Sales, Purchasing, Treasury and other departments are all located and conduct their business at its general offices in Chicago, Illinois. The executive policies [fol. 129] of the Company are determined by its officers in said general offices in Chicago, Illinois; the purchasing of supplies for its manufacturing plants, and the manufacturing orders on the manufacturing plants are issued from the general offices in Chicago, and the general policies of the Company there determined. The directors' meetings are held at the general office of the Company in Chicago, Illinois, and always have been so held. No directors' meet-

ings have ever been held in the State of Wisconsin. The facts set forth in this paragraph have been true for the entire history of the Company since September 19, 1918.

(4) Sales by the selling branches are made both for cash, and partly for cash and notes. All cash received by the selling branches and the proceeds of all notes when paid are deposited by the selling branch in its Deposit Account. Funds in the Deposit Account of a branch cannot be drawn on by the branch, but only by the office of the Treasury Department in Chicago, which regularly at fixed intervals draws out the money in the Deposit Account into the Treasury Department in Chicago. Likewise, receipts from all other operations or business of the Company and of its subsidiaries have been deposited in the Company's bank accounts located in Chicago, Illinois, and there commingled without segregation or ear-marking of any kind with the general funds of the Company.

The statements above made apply for the entire period covered by said audit, namely from September 26, 1935 to October 31, 1937.

(5) Section 14:8-19 of Revised Statutes of New Jersey 1937 provides as follows:

> "The directors of a corporation shall not pay dividends except from its surplus, including surplus as determined by section 14:8-6 of this title, or from the net profits arising from the business of the corporation, nor shall they divide, withdraw, or in any way pay to the stockholders or any of them, any part of the capital stock of the corporation or reduce its capital stock except as authorized by law."

Said Section 14:8-6 provides that the capital of a corporation with no par stock may be increased by resolution of the Board of Directors, directing that a portion of the surplus be transferred to capital account, and that the Board of Directors may direct that the surplus so transferred may be treated as capital, in respect of any share without nominal or par value.

Dividends on the common stock of the International Harvester Company are paid in quarterly installments on the 15th days of January, April, July and October of each year. Dividends on preferred stock of the Company are

paid in quarterly installments on March 1st, June 1st, September 1st and December 1st of each year.

[fol. 130] The form of resolution for common stock dividends, effective in the period from September 26, 1935, to October 31, 1937, was according to the form of which the following, contained in an extract from the minutes of the Board of Directors' Meeting of April 15, 1937, is a sample:

> "The recommendation of the Executive Committee that a quarterly dividend of sixty-two and one-half cents (62½¢) per share on the common stock of the Company be paid July 15, 1937, to all holders of record of common stock of the Company at the close of business on June 19, 1937, having been considered and the Comptroller having submitted a statement showing the surplus account at May 19, 1937, before adding profits that have accrued since October 31, 1936, and the Board having considered the same and also the current earnings and the present and probable future cash demands and resources of the Company's business.
>
> "On motion, duly made and seconded, the following resolution was unanimously adopted:
>
> "Resolved, That there be paid on July 15, 1937, to all holders of record of common stock of the Company at the close of business on June 19, 1937, a quarterly dividend of sixty-two and one-half cents (62½¢) per share on the common stock of the Company."

The preferred stock dividends in the period from September 26, 1935 to October 31, 1937 were declared by resolutions, of which the one contained in the following extract from the minutes of the Directors' meeting of April 15, 1937 is a sample:

> "The Comptroller having submitted a statement showing the surplus account at April 15, 1937, before adding profits that have accrued since October 31, 1936, and the Board having considered the same and also the current earnings and the present and probable future cash demands and resources of the Company's business,
>
> "On motion, duly made and seconded, the following resolution was unanimously adopted:

"Resolved, That a dividend of One Dollar and Seventy-five Cents ($1.75) per share, being the seventy-fifth quarterly dividend, be paid on June 1, 1937 to all holders of record of the preferred stock of this Company at the close of business on May 5, 1937.

(6) The meetings of the Board of Directors at which all the dividends in question have been declared, and all acts and proceedings in respect of the declaration and payment of such dividends, have taken place at the Company's office in the City of Chicago, Illinois, the dividends having [fol. 131] been paid by the Company's Treasury Department by checks drawn on the Company's bank accounts representing its general funds on deposit in Chicago and New York City, and mailed to its many stockholders. Such dividends have not been charged against the earnings or profits of the Company of any particular class or period, but have been charged against the surplus of the Company, which resulted from and reflected the accumulated net profits and income of the Company from its entire business wherever transacted.

(7) Either party may adduce such further facts in evidence as it shall deem material at the trial of said appeal before the Wisconsin Board of Tax Appeals.

Dated, September 20th, 1941,

R. M. Stroud, Edward R. Lewis, Attorneys for Appellant, International Harvester Company. Richard R. Teschner, Attorney for Appellee, Wisconsin Department of Taxation.

[fol. 132] EXHIBIT 7

International Harvester Company, Chicago, Illinois

Recomputation of Liability for Additional Wisconsin Privilege Dividend Taxes Computed in Accordance with Percentage of Surplus Method Ordered by Wisconsin Supreme Court in J. C. Penney Company vs. Department of Taxation, 298 N. W. 186.

A. W. Michler, Auditor.

September 22, 1941. M. M., [redacted] D.

[fol. 133] International Harvester Company

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[fol. 134]

EXHIBIT A

International Harvester Company

Recomputation of Additional Privilege Dividend Taxes

Date Declared	Date Paid	Amount of Dividend	Paid From Surplus At	Per Cent Taxable	Amount Taxable	Rate Of Tax	Amount Of Tax	Tax Previously Paid	Additional Privilege Dividend Tax
10-17-1935	12- 2-1935	$ 1,429,267.00	12-31-1934	5.78469	$ 82,678.66	.025	$ 2,066.97	$0	$ 2,066.97
11-21-1935	1-15-1936	1,273,563.90	12-31-1935	6.12580	78,015.97	.025	1,950.40	0	1,950.40
1-16-1936	3- 2-1936	1,429,267.00	12-31-1935	6.12580	87,554.03	.025	2,188.85	0	2,188.85
2-20-1936	4-15-1936	1,273,565.10	12-31-1935	6.12580	78,016.05	.025	1,950.40	0	1,950.40
4-16-1936	6- 1-1936	1,429,267.00	12-31-1935	6.12580	87,554.03	.025	2,188.85	0	2,188.85
5-21-1936	7-15-1936	1,273,565.10	12-31-1935	6.12580	78,016.05	.025	1,950.40	0	1,950.40
7-16-1936	9- 1-1936	1,429,267.00	12-31-1935	6.12580	87,554.03	.025	2,188.85	0	2,188.85
7-24-1936	10-15-1936	6,792,347.20	12-31-1935	6.12580	416,085.60	.025	10,402.14	0	10,402.14
10-15-1936	12- 1-1936	1,429,267.00	10-31-1936	6.61902	94,603.46	.025	2,365.09	0	2,365.09
11-19-1936	1-15-1937	2,653,288.94	10-31-1936	6.61902	175,621.72	.025	4,390.54	0	4,390.54
1-21-1937	3- 1-1937	1,429,267.00	10-31-1936	6.61902	94,603.46	.025	2,365.09	0	2,365.09
2-18-1937	4-15-1937	2,653,291.90	10-31-1936	6.61902	175,621.92	.025	4,390.55	0	4,390.55
4-15-1937	6- 1-1937	1,429,267.00	10-31-1936	6.61902	94,603.46	.025	2,365.09	0	2,365.09
5-20-1937	7-15-1937	2,653,293.96	10-31-1936	6.61902	175,622.05	.025	4,390.55	0	4,390.55
7-15-1937	9- 1-1937	1,429,267.00	10-31-1936	6.61902	94,603.46	.025	2,365.09	0	2,365.09
8-19-1937	10-15-1937	9,021,136.12	10-31-1936	6.61902	597,110.80	.025	14,927.77	0	14,927.77
Total		$39,028,188.22			$2,497,864.75		$62,446.63	$0	$62,446.63

[fol. 135]

EXHIBIT B

International Harvester Company

Analysis of Surplus

		Total	Wisconsin	Outside	Percent Wisconsin	Reference for Percentage
Balance January 1, 1928		$68,255,323.16	$	$		
1928 Income		21,394,298.41	1,269,937.72	20,124,360.69	5.93587	Schedule 1
1928 Transfer to common capital stock December 11, 1928 on change of common stock from par value of $100.00 per share to no par value, and issue of four shares of no par value common for each share of $100.00 par value common stock		66,137,770.00				
1928 Dividends paid	$17,030,752.12	2,117,553.16				
1928 Dividends paid		14,913,198.96	885,228.10	14,027,970.86	5.93587	
Balance December 31, 1928		6,481,099.45	384,709.62	6,096,389.83	5.93587	
1929 Income		31,481,344.16	1,931,975.45	29,549,368.71	6.13689	Schedule 1
1929 Dividends paid	$16,465,629.13	6,481,099.45	384,709.63	6,096,389.82	5.93587	
1929 Dividends paid		9,984,529.68	612,739.59	9,371,790.09	6.13689	
Balance December 31, 1929		21,496,814.48	1,319,235.85	20,177,578.63	6.13689	
1930 Income		23,497,079.80	1,309,151.56	22,187,928.24	5.57155	Schedule 1
1930 Dividends paid		16,669,167.45	1,022,968.44	15,646,199.01	6.13689	
Balance December 31, 1930		28,324,726.83	1,605,418.97	26,719,307.86	5.66790	
1931 Income of companies in Wisconsin consolidation		9,190,235.47	568,082.22	8,622,153.25	6.18136	Schedule 4
1931 Income of other domestic companies and steel department		4,950,670.11		4,950,670.11		
1931 Dividends paid		16,758,909.50	949,878.20	15,809,031.30	5.66790	
1931 Transfer to surplus from sundry contingent reserves		11,000,000.00	623,469.00	10,376,531.00	5.66790	
Balance December 31, 1931		26,805,382.69	1,847,091.99	24,958,290.70	6.89075	
1932 Income of companies in Wisconsin consolidation		3,079,761.15	208,321.20	2,871,439.95	6.76420	Schedule 1
1932 Income of other domestic companies and steel department		1,199,642.88		1,199,642.88		
1932 Dividends paid		12,046,878.22	830,120.25	11,216,757.97	6.89075	
1932 Transfer to surplus from contingent reserves		10,000,000.00	689,075.00	9,310,925.00	6.89075	

EXHIBIT B—Continued

International Harvester Company

Analysis of Surplus

	Total	Wisconsin	Outside	Percent Wisconsin	Reference for Percentage
Balance December 31, 1932	20,479,100.44	1,497,725.54	18,981,374.90	7.31343	
1933 Income of companies in Wisconsin consolidation	4,908,228.51	75,250.02	4,832,978.49	1.53314	Schedule 4
1933 Income of other domestic companies and steel department	1,682,257.85	.....	1,682,257.85	.....	
1933 Transfer to surplus from contingent reserves	10,000,000.00	731,343.00	9,268,657.00	7.31343	
1933 Dividends paid	8,242,005.47	602,773.29	7,639,232.18	7.31343	
Balance December 31, 1933	25,463,065.63	1,701,545.27	23,761,520.36	6.68240	
1934 Income of companies in Wisconsin consolidation	7,959,146.63	351,573.81	7,607,572.82	4.41723	Schedule 1
1934 Income of other domestic companies and steel department	787,580.80	.....	787,580.80	.....	
1934 Dividends paid	8,264,040.00	552,236.20	7,711,803.80	6.68240	
[fol. 136]					
Balance December 31, 1934	25,945,753.06	1,500,882.88	24,444,870.18	5.78469	
1935 Income of companies in Wisconsin consolidation	15,972,826.47	1,240,465.72	14,732,360.75	7.76610	Schedule 1
1935 Income of other domestic companies and steel department	3,325,870.98	.....	3,325,870.98	.....	
1935 Dividends paid	8,864,824.20	512,802.60	8,352,021.60	5.78469	
Balance December 31, 1935	36,379,626.31	2,228,546.00	34,151,080.31	6.12580	
1936 Income of companies in Wisconsin consolidation	24,050,457.68	1,848,272.88	22,202,184.80	7.68498	Schedule 1
1936 Income of other domestic companies and steel department	2,365,225.73	.....	2,365,225.73	.....	
1936 Net transfer of contingent reserves to surplus	137,893.55	8,447.08	129,446.47	6.12580	
1936 Dividends paid	16,280,567.34	997,314.97	15,283,252.37	6.12580	
Balance October 31, 1936	46,652,635.93	3,097,950.99	43,564,684.94	6.61902	

[fol. 137]

SCHEDULE 1

International Harvester Company

Computation of Per Cent of Wisconsin Taxable Income to Total Income

	Total Income	Wisconsin Taxable Income	Per Cent Wisconsin To Total	Reference
1928 Taxable Income	$48,381,125.12	$2,871,841.03	5.93587	Amended Exhibit C of 1925 to 1930 Audit Report.
1929 Taxable Income	51,951,218.48	3,188,190.03	6.13689	Amended Exhibit C of 1925 to 1930 Audit Report.
1930 Taxable Income	24,210,850.66	1,348,921.09	5.57155	Amended Exhibit C of 1925 to 1930 Audit Report.
1931 Taxable Income	.....	.....	6.18136	See Schedule 4.
1932 Taxable Income	14,147,751.83	956,982.94	6.76420	See Schedule 3.
1933 Taxable Income	.....	.....	1.53314	See Schedule 4.
1934 Taxable Income	15,216,754.81	672,160.09	4.41723	Amended Exhibit B-1 of 1931 to 1936 Audit Report.
1935 Taxable Income	36,055,388.97	2,800,101.00	7.76610	Amended Exhibit B-1 of 1931 to 1936 Audit Report.
1936 Taxable Income	31,244,230.66	2,401,114.90	7.68498	Amended Exhibit B-1 of 1931 to 1936 Audit Report.

[fol. 138]

SCHEDULE 2

International Harvester Company

Computation of Book Income of Companies Included in Wisconsin Consolidation

	1931	1932	1933	1934	1935	1936
Consolidated Book Income of Domestic Companies	$4,239,565.36	$4,279,404.03	$3,225,970.66	$8,746,727.43	$19,298,697.45	$26,415,683.41(1)
Book Income of Companies not included in Wisconsin Consolidation:						
International Harvester Company of Argentina	2,437,327.44	1,244,141.70	302,377.73	32,821.27	538,312.05	400,062.35
Wisconsin Steel Company	118,784.64	4,561.81	100,093.37	40,354.78	104,783.57	40,319.40
Wisconsin Lumber Company	69,684.77	9,354.70	18,616.60	26,138.68	55,716.01	.....
Chicago, West Pullman & Southern Railroad Co	28,503.31	22,972.71	31,500.21	65,916.59	171,976.63	115,379.39
Illinois Northern Railway Company	31,755.05	48,538.21	4,841.02	36,049.19	93,288.08	42,456.20
Steel Department of International Harvester Company	2,264,614.90	2,377,066.55	1,287,829.34	667,009.85	2,473,226.66	1,847,656.78
Total	4,950,670.11	1,199,642.88	1,682,257.85	787,580.80	3,325,870.98	2,365,225.73
Book Income of Companies Included in Wisconsin Consolidation	$9,190,235.47	$3,079,761.15	$4,908,228.51	$7,959,146.63	$15,972,826.47	$24,050,457.68

(1) Consolidated income per tax return	$26,362,847.82
Add: Chicago, West Pullman & Southern Railway Company	115,379.39
Illinois Northern Railway Company	42,456.20
	$26,520,683.41
Deduct: Dividends received by International Harvester Company from:	
Chicago, West Pullman & Southern Railway Company	80,000.00
Illinois Northern Railway Company	25,000.00
	$ 105,000.00
	$26,415,683.41

[fol. 139]

SCHEDULE 3

International Harvester Company

Computation of 1932 Wisconsin Taxable Income

Total net loss for 1932 per Amended Exhibit B-1 of 1931-1936 audit report			$14,147,751.83
Deduct: Non-Apportionable income per 1932 tax return:			
Dividends received		$1,452,940.38	
Interest received on investments		133,956.80	
		1,586,897.18	
Deduct: Interest paid		139,539.10	
			1,447,358.08
Apportionable net loss			15,595,109.91
Percent Wisconsin:			
1928 percent Wisconsin taxable income to total apportionable income	6.24012		
1929 percent Wisconsin taxable income to total apportionable income	6.28279		
1930 percent Wisconsin taxable income to total apportionable income	5.88639		
Total	18.40930		
Average	6.13643		6.13643
1932 Wisconsin taxable income			956,982.94

[fol. 140]

SCHEDULE 4

International Harvester Company

Computation of Wisconsin Portion of 1931 and 1933 Book Income

1931	Amount	Per Cent
Book Income of Companies included in Wisconsin Consolidation, per Schedule 2	$9,190,235.47	100.00000
Deduct: Non-apportionable income per Amended Exhibit B-1 of 1931-1936 Audit Report	1,915,728.80	
Apportionable Book Income of Companies included in Wisconsin Consolidation	7,274,506.67	
Per Cent Wisconsin per Amended Exhibit B-1 of 1931-1936 Audit Report	7.80922	
Book Income Apportioned to Wisconsin	$ 568,082.22	6.18136
1933		
Book Income of Companies Included in Wisconsin Consolidation, per Schedule 2	$4,908,228.51	100.00000
Deduct: Non-apportionable income per Amended Exhibit B-1 of 1931-1936 Audit Report	3,948,479.01	
Apportionable Book Income of Companies included in Wisconsin Consolidation	959,749.50	
Per Cent Wisconsin per Schedule 5	7.84059	
Book Income Apportioned to Wisconsin	$ 75,250.02	1.53314

[fol. 141] SCHEDULE 5

International Harvester Company

Computation of 1933 Apportionment Percentage

		Wisconsin	Total	Percent
Tangible Assets (per Exhibit E of original 1931 to 1936 audit report		$10,274,197.00	$131,751,145.00	7.79818
Cost of Manufacturing (per Exhibit E of original 1931 to 1936 audit report)		2,846,963.00	22,772,417.00	12.50180
Sales				
Percent Wisconsin sales to total sales (per Exhibit E of original 1931 to 1936 audit report)	1934	3.14097		
Percent Wisconsin sales to total sales (per Exhibit E of original 1931 to 1936 audit report)	1935	3.31314		
Percent Wisconsin sales to total sales (per Exhibit E of original 1931 to 1936 audit report)	1936	3.20925		
Total		9.66536		
Average		3.22179		3.22179
Total				23.52177
Average				7.84059

[fol. 142] EXHIBIT 7a

Wisconsin Board of Tax Appeals, Madison, Wisconsin

Stipulation. Docket No. D-5

INTERNATIONAL HARVESTER COMPANY, Petitioner,

v.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

The petitioner having requested and reserved the right to analyze and check the recomputation prepared by the respondent herein and received in evidence by the Wisconsin Board of Tax Appeals at a hearing on September 23,

1941, and the petitioner and respondent having conferred thereafter at length with the result that,

It Is Hereby Stipulated and Agreed:

1. That if, under the facts heretofore stipulated herein it is presumed that International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business, reflected in its surplus, bore to its total surplus, then the analysis of surplus and determination of the portion of the dividends paid by said petitioner out of its surplus attributable to Wisconsin earnings, and the computation of the privilege dividend tax thereon, are correctly set forth in Exhibit "A" attached hereto and made a part hereof.

[fol. 143] 2. That this stipulation and agreement supersedes the recomputation already in evidence herein as Exhibit 7, and, subject to the conditions hereof, determines the liability of the petitioner, exclusive of penalty and interest, the petitioner, however, reserving the right to contest the validity of the privilege dividend tax law as applied to income or surplus accumulated prior to the enactment of said law, or as applied on the presumption that the International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business, reflected in its surplus, bore to its total surplus, or as in any manner applied to the petitioner.

Dated this 22nd day of November, 1941.

International Harvester Company, by Stroud, Stebbins & Wingert, Edward R. Lewis, Its Attorneys; Wisconsin Department of Taxation, by Richard R. Teschner, Its Atty.

[fol. 144] International Harvester Company, Chicago, Illinois

Computation of Wisconsin Privilege Dividend Taxes

In Accordance with Percentage of Surplus Method Ordered by Wisconsin Supreme Court in J. C. Penney Company vs. Department of Taxation, 298 N. W., 186 and on Basis of an Analysis of the *Separate* Surplus of International Harvester Company.

November 17, 1941. M. M.

[fol. 145] International Harvester Company

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[fol. 146]

EXHIBIT A

International Harvester Company

Computation of Additional Privilege Dividend Taxes

Date Declared	Date Paid	Amount of Dividend	Paid From Surplus At	Per Cent Taxable	Amount Taxable	Rate of Tax	Amount of Tax	Tax Previously Paid	Additional Privilege Dividend Tax
10-17-1935	12- 2-1935	$ 1,429,267.00	12-31-34	3.08907	$ 44,151.06	.025	$ 1,103.78	$0	$ 1,103.78
11-21-1935	1-15-1936	1,273,563.90	12-31-35	5.28384	67,293.08	.025	1,682.33	0	1,682.33
1- 6-1936	3- 2-1936	1,429,267.00	12-31-35	5.28384	75,520.18	.025	1,888.00	0	1,888.00
2-20-1936	4-15-1936	1,273,565.10	12-31-35	5.28384	67,293.14	.025	1,682.33	0	1,682.33
4-16-1936	6- 1-1936	1,429,267.00	12-31-35	5.28384	75,520.18	.025	1,888.00	0	1,888.00
5-21-1936	7-15-1936	1,273,565.10	12-31-35	5.28384	67,293.14	.025	1,682.33	0	1,682.33
7-16-1936	9- 1-1936	1,429,267.00	12-31-35	5.28384	75,520.18	.025	1,888.00	0	1,888.00
7-24-1936	10-15-1936	6,792,347.20	12-31-35	5.28384	358,896.76	.025	8,972.42	0	8,972.42
10-15-1936	12- 1-1936	1,429,267.00	10-31-36	5.80245	82,932.50	.025	2,073.31	0	2,073.31
11-19-1936	1-15-1937	2,653,288.94	10-31-36	5.80245	153,955.76	.025	3,848.89	0	3,848.89
1-21-1937	3- 1-1937	1,429,267.00	10-31-36	5.80245	82,932.50	.025	2,073.31	0	2,073.31
2-18-1937	4-15-1937	2,653,291.90	10-31-36	5.80245	153,955.94	.025	3,848.90	0	3,848.90
4-15-1937	6- 1-1937	1,429,267.00	10-31-36	5.80245	82,932.50	.025	2,073.31	0	2,073.31
5-20-1937	7-15-1937	2,653,293.96	10-31-36	5.80245	153,956.06	.025	3,848.90	0	3,848.90
7-15-1937	9- 1-1937	1,429,267.00	10-31-36	5.80245	82,932.50	.025	2,073.31	0	2,073.31
8-19-1937	10-15-1937	9,021,136.12	10-31-36	5.80245	523,446.91	.025	13,086.17	0	13,086.17
		$39,028,188.22			$2,148,532.39		$53,713.29	...	$53,713.29

[fol. 147] EXHIBIT B

International Harvester Company (Separate)

Determination of Portion of Surplus Attributable to Wisconsin

	Total Surplus	% to Wisconsin	Wisconsin Surplus	References
Balance December 31, 1930	$ 2,339,122.28		$	
Income 1931	23,551,959.82	None		*
Transferred from Reserves	11,000,000.00	5.88639	647,502.90	1930 Per Cent
Dividends Paid	16,758,909.50	2.01007	336,865.81	
Balance December 31, 1931	$15,453,928.04	2.01008	$ 310,637.09	
Income 1932	3,642,580.13	None		*
Transferred from Reserves	10,000,000.00	5.88639	588,639.00	1930 Per Cent
Dividends Paid	12,046,378.22	2.01008	242,151.89	
Balance December 31, 1932	$17,049,629.95	3.85418	$ 657,124.20	
Income 1933	5,465,321.95	None		*
Transferred from Reserves	10,000,000.00	5.88639	588,639.00	1930 Per Cent
Dividends Paid	8,242,005.47	3.85418	317,661.73	
Balance December 31, 1933	$24,272,946.43	3.82360	$ 928,101.47	
Income 1934	11,011,230.90		250,526.98	(See Attached Ex. C)
Transferred from Reserves	2,500,000.00)	5.88639	58,863.90	1930 Per Cent
Transferred to Reserves	3,500,000.00)			
Dividends Paid	8,264,040.00	3.82360	315,983.83	
Balance December 31, 1934	$26,020,137.33	3.08907	$ 803,780.72	
Income 1935	25,001,516.03		1,697,558.93	(See Attached Ex. C)
Dividends Paid	8,864,824.20	3.08907	273,340.62	
Balance December 31, 1935	$42,156,829.16	5.28384	$2,227,499.03	
Income 1936	18,948,047.35		1,233,531.41	(See Attached Ex. C)
Transferred from Reserves	25,148,073.76)	5.88639	8,116.95	1930 Per Cent
Transferred to Reserves	25,010,180 21)			
Dividends Paid	16,250,567.34	5.28384	860,239.13	
Balance October 31, 1936	$44,962,202.72	5.80245	$2,608,908.26	

* No income was taxed in Wisconsin in 1931, 1932, or 1933, therefore, no book income has been allocated to Wisconsin in any of these years.

[fol. 148]

EXHIBIT B-1

International Harvester Company

Analysis of Surplus—December 31, 1927 to December 31, 1932 Showing Elimination of Amounts Arbitrarily Taken Over From Subsidiary Corporations

	I. H. Co.	Subsidiaries	Total
December 31, 1927	$51,022,748.37	$.....	$51,022,748.37
Net Profit 1928	19,837,576.54	.....	19,837,576.54
Charge to Export Co.	269,119.64	.....	269,119.64
Dividends Paid	17,030,752.12	.....	17,030,752.12
Transferred to C/S account	66,137,770.00	.....	66,137,770.00
Transferred from Subsidiaries	.....	14,491,356.67	14,491,356.67
December 31, 1928	$12,039,077.57	$14,491,356.67	$ 2,452,279.10
Net Profit 1929	20,377,852.64	.....	20,377,852.64
Dividends Paid	16,465,629.13	.....	16,465,629.13
Transferred to Subsidiaries	.....	14,491,356.67	14,491,356.67
Transferred from Subsidiaries	.....	12,934,431.52	12,934,431.52
December 31, 1929	$ 8,126,854.06	$12,934,431.52	$ 4,807,577.46
Net Profit 1930	22,456,899.23	.....	22,456,899.23
Dividends Paid	16,669,167.45	.....	16,669,167.45
Transferred to Subsidiaries	.....	12,934,431.52	12,934,431.52
Transferred from Subsidiaries	.....	14,735,291.48	14,735,291.48
December 31, 1930	$ 2,339,122.28	$14,735,291.48	$12,396,169.20
Net Profit 1931	23,551,959.82	.....	23,551,959.82
Transferred from Reserves	11,000,000.00	.....	11,000,000.00
Dividends Paid	16,758,909.50	.....	16,758,909.50
Transferred to Subsidiaries	.....	14,735,291.48	14,735,291.48
Transferred from Subsidiaries	.....	9,685,759.28	9,685,759.28
December 31, 1931	$15,453,928.40	$ 9,685,759.28	$23,139,687.32
Net Profit 1932	3,642,580.13	.....	3,642,580.13
Transferred from Reserves	10,000,000.00	.....	10,000,000.00
Dividends Paid	12,046,878.22	.....	12,046,878.22
Transferred to Subsidiaries	.....	9,685,759.28	9,685,759.28
Transferred from Subsidiaries	.....	.....	.....
December 31, 1932	$17,049,629.95	$.....	$17,049,629.95

[fol. 149] EXHIBIT C

International Harvester Company

Book Income Allocated to Wisconsin

	1934	1935	1936
Net Income per Books	$11,011,230.90	$25,001,516.03	$18,948,047.35
Less Non-Apportionable Income:			
Dividends	$ 8,367,893.83	$ 7,397,810.00	$ 1,999,558.95
Less—I. H. Co. of America	1,500,000.00	5,000,000.00	200,000.00
Macleod & Co.	500,000.00	100,000.00	25,000.00
Steel Department Profit or Loss	667,009.85	2,473,226.66	1,847,656.78
Gains or Losses on Sales of Stocks, Bonds, or other capital assets	7,115.13	943,232.98	282,205.31
Engineering and Research Fees	120,118.16	125,249.18	151,428.90
Interest on Bonds	759,743.80	520,403.53	198,492.96
Royalties	5,052.41	5,155.09	5,718.47
Interest Paid	49,068.79	17,664.88	37,591.65
Total Non-apportionable	$ 7,863,634.13	$ 4,460,946.60	$ 3,649,959.10
Apportionable Income	$ 3,147,596.77	$20,540,569.43	$15,298,988.25
Ratios to Wisconsin*	7.95931	8.26442	8.06283
Income to Wisconsin	$ 250,526.98	$ 1,697,558.93	$ 1,233,531.41

* From Wisconsin Audit Report 1931 to 1936, Amended Exhibit B-1.

[fol. 150] BEFORE WISCONSIN BOARD OF TAX APPEALS

Docket D-5

Privilege Dividend Tax Appeal

INTERNATIONAL HARVESTER COMPANY

vs.

WISCONSIN DEPARTMENT OF TAXATION

SUPPLEMENTARY STIPULATION OF FACTS—Filed December 23, 1941

This Stipulation of Facts is supplementary to the Stipulation of Facts executed by the parties to the above Privilege Dividend Tax Appeal on September 20, 1941.

The parties hereby stipulate that during the period from September 26, 1935 to October 15, 1937, the International Harvester Company had more than 32,000 stockholders residing in every State of the United States and many

foreign countries, of whom less than 2% resided in the State of Wisconsin.

Dated December 23rd, 1941.

R. M. Stroud, Attorneys for Appellant International Harvester Company, Richard R. Teschner, Attorney for Appellee Wisconsin Department of Taxation.

[fol. 151] BEFORE WISCONSIN BOARD OF TAX APPEALS

Docket No. D-5

INTERNATIONAL HARVESTER COMPANY, a New Jersey Corporation, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

DECISION AND ORDER—Filed February 13, 1942

This is an appeal by the petitioner from an assessment of privilege dividend taxes resulting from the respondent's audit of dividend payments made by the petitioner during the period from September 26, 1935 to October 15, 1937, inclusive.

From the stipulations presented and the record before us, we make the following findings of fact: The petitioner is a corporation organized under the laws of the State of New Jersey. Its principal office is in Hoboken. During the period under review, its general offices have been located in Chicago, Illinois. The petitioner does business in every state of the United States except Nevada. Since [fol. 152] 1920, the petitioner has had a manufacturing plant and selling branches in Wisconsin. No directors' meetings are held in this state. The meetings at which the dividends in question were declared, and all acts and proceedings with respect to the declaration and payment of such dividends, occurred at Chicago.

Dividends on its common stock are paid in quarterly installments on the 15th day of January, April, July, and October, and dividends on preferred stock are paid in March, June, September, and December.

During the period here involved, the petitioner had more than 32,000 stockholders residing in every State of the

United States and many foreign countries, of whom less than 2% resided in Wisconsin.

On December 2, 1937, the respondent levied an additional assessment against the petitioner in the sum of $68,838.49, exclusive of penalties and interest. Thereafter the Wisconsin Supreme Court, on remand from the United States Supreme Court, rendered its decision in *J. C. Penney Co. vs. State of Wisconsin, et al.*, 298 NW 186 (reversing 233 Wis. 286). Subsequent to the decision therein, the respondent recomputed the amount of privilege dividend taxes, and under date of September 22, 1941, prepared an [fol. 153] audit report setting forth its recomputation of the petitioner's liability for additional privilege dividend taxes. This later recomputation was supplemented by one dated November 17, 1941, in which the petitioner's separate surplus was analyzed and a computation of privilege dividend taxes made with reference to such separate surplus.

The analysis of surplus and the determination of the portion of the dividends paid by the petitioner out of its surplus attributable to Wisconsin earnings, as well as the mathematical computation of the privilege dividend taxes thereon, are not here disputed.

Following the petitioner's receipt of notice of the assessment of additional privilege dividend taxes (under date of December 2, 1937), the petitioner protested the proposed assessment and requested a hearing thereon. This appeal was pending with the Tax Commission at the time that Chapter 412, Laws of 1939, was passed, and pursuant to the provisions of that Act, the within appeal was transferred to this Board.

The following question is presented for determination: Is the method of computation employed by the respondent for the purpose of computing the privilege dividend taxes due, by virtue of Section 71.60, Section 3, upon dividends declared and paid by the petitioner out of income derived [fol. 154] from property located and business transacted in this state, valid?

The Wisconsin statutes involved are:

Section 71.60:

"Section 3. Privilege Dividend Tax. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business

transacted in this state, there is hereby imposed a tax equal to three per centum of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1941. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation,

" • • •

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state."

[fol. 155] The respondent's computation of additional privilege dividend taxes is based upon the presumption that the petitioner paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business, reflected in its surplus, bore to its total surplus.

The petitioner predicates its contention that the privilege dividend taxes here sought to be imposed by the respondent are invalid upon its conclusion that Section 71.60, Section 3, gives no right to this State to tax dividends from prior years' income. It further maintains that said Section grants to the State the right to tax only dividends from current income which, in the absence of proof to the contrary, is presumed to be the same as the income for the

year immediately preceding and does not permit the taxation of dividends from surplus.

Our study of the Court's decision in *J. C. Penney*, supra, (May 20, 1941) convinces us that the respondent's method of computation of additional privilege dividend taxes set forth in Exhibit 7A complies with the statutory requirements (Section 71.60, Section 3), and is in conformity with the construction of that Statute as given to it by the Wisconsin Supreme Court. The applicable portion of the de- [fol. 156] cision in that case declares:

> "• • • The Wisconsin earnings and earnings for particular calendar years were not segregated and had lost their identity long before the dividends here involved were paid. It is the contention of the taxpayer that the presumption created by the statute (1) is invalid and (2) has been rebutted. The taxpayers' contention requires us to consider the nature of the presumption. By its terms it operates only in the absence of evidence. Its effect is to require the taxpayer to go forward with the evidence. When evidence is introduced which rebuts it the presumption ceases to operate because it rests upon no factual basis and takes no account of the way in which the transactions of the Company are actually handled. Being a rebuttable presumption it is clearly within the power of the Legislature to create it. Evidence having been introduced which rebuts it, the controversy must be determined upon general principles of law. It is obvious from a consideration of the facts that the so-called 'trust fund' doctrine has no application to the facts in this case. The earnings of the corporation are in no sense held by it in trust for the taxing authorities of the state. The earnings are handled according to ordinary business practice. They are not earmarked or segregated or manipulated in any manner whatever. When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the Company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be pre-

sumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus * * *."

[fols. 157-158] The argument advanced by the petitioner with respect to the respondent's authority to levy a tax upon dividends paid out of earnings derived prior to the effective date of the privilege dividend tax law is disposed of, in our judgment, by the decision in *J. C. Penney*, supra.

We find that the method of computation (set forth in Exhibit 7A), which the respondent used in determining the amount of privilege dividend taxes on dividends declared and paid by the petitioner out of income derived from business transacted and property located within the State of Wisconsin, is proper.

It Is Ordered:

That the additional assessment appealed from, as modified and amended by the recomputation of November 17, 1941, be and the same is hereby affirmed.

Dated at the State Capitol, Madison, Wisconsin, this 13th day of February, 1942.

Wisconsin Board of Tax Appeals, G. L. Broadfoot, Chairman; W. J. Conway, Harry Slater.

[fol. 159] In Circuit Court of Dane County, State of Wisconsin

No. —

International Harvester Company, Petitioner,

vs.

Wisconsin Board of Tax Appeals, Respondent

Petition on Appeal—March 12, 1942

To the Honorable Judge of the Circuit Court, County of Dane, State of Wisconsin:

(1) The full name of the Petitioner is International Harvester Company.

(2) This is an appeal from the decision and order of the Wisconsin Board of Tax Appeals, filed February 13, 1942,

with respect to the assessment of additional Wisconsin Privilege Dividend Taxes during the period from September 26, 1935 to October 15, 1937 inclusive. Said decision and order of said Wisconsin Board of Tax Appeals, a copy of which is attached hereto, marked Exhibit A and made a part hereof, is signed by G. L. Broadfoot, Chairman, and W. J. Conway and Harry Slater, members of said Wisconsin Board of Tax Appeals. In said decision and order, dated February 13, 1942, it was ordered: "That the additional assessment appealed from, as modified and amended by the recomputation of November 17, 1941, be and the same is hereby affirmed." Said recomputation of November 17, 1941 showed a total amount of additional Wisconsin Privilege Dividend taxes for said period of $53,713.29, penalty and interest to January 1, 1942 of $16,375.60, or total taxes, penalty and interest of $70,088.89.

(3) The facts upon which the Petitioner relies are as follows:

[fol. 160] (a) The International Harvester Company is a corporation organized September 19, 1918, under the laws of the State of New Jersey. Its principal office is in Hoboken, New Jersey. During the entire period since September 26, 1935, when the Wisconsin Privilege Dividend Tax became effective, the general offices of the International Harvester Company have been located, until October 1937, at 606 South Michigan Avenue, and since then at 180 North Michigan Avenue, Chicago, Illinois.

(b) The International Harvester Company is admitted to do business in every state of the United States except Nevada, and has been so admitted since January 1, 1936. Until December 31, 1935, the products manufactured by the International Harvester Company were distributed in the United States by the International Harvester Company of America, a Wisconsin corporation, all of whose capital stock was owned or controlled by the International Harvester Company, and the International Harvester Company of America operated all the selling branches in Wisconsin and the rest of the United States. Since 1920 the International Harvester Company has had manufacturing plants in Illinois, Indiana, New York, Tennessee, Ohio, Louisiana and in Milwaukee, Wisconsin. It has more than 100 selling branches in the United States. In the State of

Wisconsin it has selling branches in Milwaukee, Madison, Eau Claire and Green Bay. After December 31, 1935, except in Wisconsin, said products manufactured by the International Harvester Company were distributed by the branches of the International Harvester Company, and since October 31, 1939, all the branches in the United States have been owned and operated by the International Harvester Company. In the last fifteen years there have been [fol. 161] more than 100 selling branches in the United States.

(c) The executive offices of the International Harvester Company are located at its general offices in Chicago, Illinois. The heads of its various departments, Executive, Manufacturing, Sales, Purchasing, Treasury and other departments are all located and conduct their business at its general offices in Chicago, Illinois. The executive policies of the Company are determined by its officers in said general offices in Chicago, Illinois; the purchasing of supplies for its manufacturing plants, and the manufacturing orders on the manufacturing plants are issued from the general offices in Chicago, and the general policies of the Company there determined. The directors' meetings are held at the general office of the Company in Chicago, Illinois, and always have been so held. No directors' meetings have ever been held in the State of Wisconsin. The facts set forth in this paragraph have been true for the entire history of the Company since September 19, 1918.

(d) Sales by the selling branches are made both for cash, and partly for cash and notes. All cash received by the selling branches and the proceeds of all notes when paid are deposited by the selling branch in its Deposit Account. Funds in the Deposit Account of a branch cannot be drawn on by the branch, but only by the office of the Treasury Department in Chicago, which regularly at fixed intervals draws out the money in the Deposit Account into the Treasury Department in Chicago. Likewise, receipts from all other operations or business of the Company and of its subsidiaries have been deposited in the Company's bank accounts located in Chicago, Illinois, and there commingled without segregation or ear-marking of any kind [fol. 162] with the general funds of the Company. The statements above made apply for the entire period covered

by said audit, namely from September 26, 1935 to October 15, 1937 inclusive.

(e) Section 14:8-19 of Revised Statutes of New Jersey 1937 provides as follows:

> "The directors of a corporation shall not pay dividends except from its surplus, including surplus as determined by section 14:8-6 of this title, or from the net profits arising from the business of the corporation, nor shall they divide, withdraw, or in any way pay to the stockholders or any of them, any part of the capital stock of the corporation or reduce its capital stock except as authorized by law."

Said Section 14:8-6 provides that the capital of a corporation with no par stock may be increased by resolution of the Board of Directors, directing that a portion of the surplus be transferred to capital account, and that the Board of Directors may direct that the surplus so transferred may be treated as capital, in respect of any share without nominal or par value.

Dividends on the common stock of the International Harvester Company are paid in quarterly installments on the 15th days of January, April, July and October of each year. Dividends on preferred stock of the Company are paid in quarterly installments on March 1st, June 1st, September 1st and December 1st of each year.

The form of resolutions for common stock dividends, effective in the period from September 26, 1935 to and including the dividend paid October 15, 1937, was according to the form of which the following is a sample:

> "The recommendation of the Executive Committee that a quarterly dividend of sixty-two and one-half cents (62½¢) per share on the common stock of the Company be paid July 15, 1937, to all holders of record of common stock of the Company at the close of business on June 19, 1937, having been considered and [fol. 163] the Comptroller having submitted a statement showing the surplus account at May 19, 1937, before adding profits that have accrued since October 31, 1936, and the Board having considered the same and also the current earnings and the present and probable future cash demands and resources of the Company's business.

"On motion, duly made and seconded, the following resolution was unanimously adopted:

"Resolved, That there be paid on July 15, 1937, to all holders of record of common stock of the Company at the close of business on June 19, 1937, a quarterly dividend of sixty-two and one-half cents (62½¢) per share on the common stock of the Company."

Preferred stock dividends in the period from September 26, 1935 to October 31, 1937 were declared by resolutions of which the following is a sample:

"The Comptroller having submitted a statement showing the surplus account at April 15, 1937, before adding profits that have accrued since October 31, 1936, and the Board having considered the same and also the current earnings and the present and probable future cash demands and resources of the Company's business,

"On motion, duly made and seconded, the following resolution was unanimously adopted:

"Resolved, That a dividend of One Dollar and Seventy-five Cents ($1.75) per share, being the seventy-fifth quarterly dividend, be paid on June 1, 1937 to all holders of record of the preferred stock of this Company at the close of business on May 5, 1937."

(f) The meetings of the Board of Directors at which all the dividends in question have been declared, and all acts and proceedings in respect of the declaration and payment of such dividends, have taken place at the Company's office in the City of Chicago, Illinois, the dividends having been paid by the Company's Treasury Department by checks drawn on the Company's bank accounts representing its general funds on deposit in Chicago and New [fol. 164] York City, and mailed to its many stockholders. Such dividends have not been charged against the earnings or profits of the Company of any particular class or period, but have been charged against the surplus of the Company, which resulted from and reflected the accumulated net profits and income of the Company from its entire business wherever transacted. During the period from September 26, 1935 to October 23, 1940, both inclusive, the International Harvester Company had more than 32,000 stock-

holders residing in every state of the United States and in many foreign countries, of whom less than 2% resided in the State of Wisconsin.

(4) Petitioner's objections to the determination appealed from and the contentions of law upon which petitioner relies are as follows:

(a) The Wisconsin Privilege Dividend Tax is not an additional tax on income, but is a tax on the privilege of declaring and receiving dividends. The Petitioner contends, however, that the privilege of declaring dividends is not exercised in Wisconsin, and the privilege of receiving dividends is not exercised in Wisconsin in the case of more than 98% of its stockholders.

(b) The Wisconsin Privilege Dividend Tax is levied on the business of declaring and receiving dividends out of income derived from property located and business transacted in Wisconsin. The Petitioner contends, however, that the dividends of the International Harvester Company are not paid out of income, but are paid out of surplus as of the end of the year prior to the date of declaration of the dividend.

(c) Under the Wisconsin Privilege Dividend Tax no [fol. 165] right is given to tax dividends from income of prior years. The statute gives the right to tax dividends only from current income which, in the absence of proof to the contrary, is presumed to be the same as the income for the year immediately preceding. If that presumption is rebutted, the statute gives no right to tax income from prior years. It gives the right to tax only income of the current year which, in the absence of proof to the contrary, is presumed in the case of corporations doing business in and out of Wisconsin to be the same as income for the current year. The Petitioner contends, therefore, that it is current year income which is to be taxed, and therefore that the statute gives no right to tax dividends derived from surplus which is income of prior years.

(d) The statute gives no right to tax dividends derived from income of any year before the Privilege Dividend Tax took effect on September 26, 1935, and accordingly gives no right to tax dividends paid out of surplus accumulated prior to September 26, 1935.

(5) Petitioner does not admit that any portion of the additional assessment appealed from of Wisconsin Privilege Dividend Taxes, penalty and interest, as modified and amended by the recomputation dated November 17, 1941, is due.

(6) In accordance with the provisions of Section 71.10 (6)(a) of the Wisconsin statutes, Petitioner elected to deposit the entire amount of the additional taxes herein appealed from, together with interest thereon, with the State Treasurer, and the Wisconsin Department of Taxation issued its certificate to the said State Treasurer, authorizing him to accept payment of such taxes, together with interest thereon to the first day of the succeeding month and to give [fol. 166] his receipt therefor. This payment has been made and the State Treasurer's receipt has been issued therefor under date of January 3, 1942.

(7) Petitioner prays that its appeal from said additional assessments of Wisconsin Privilege Dividend Taxes and interest be granted, and that the assessments under review be modified to state that there is no Wisconsin Privilege Dividend Tax due from said International Harvester Company to the State of Wisconsin, and that the Treasurer of the State of Wisconsin be directed to refund to said International Harvester Company said amount of $70,088.89 on account of Wisconsin Privilege Dividend Taxes penalty and interest, together with interest on the said amount of $70,088.89 from the date of payment thereof.

March 12, 1942.

Respectfully submitted, International Harvester Company, Petitioner. By A. B. Keller, Vice President, R. M. Stroud, Edward R. Lewis, Its Attorneys.

[fol. 167] IN CIRCUIT COURT OF DANE COUNTY

INTERNATIONAL HARVESTER COMPANY, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

Before Hon. Alvin C. Reis, Judge

DECISION—August 14, 1942

BY THE COURT:

This is an appeal from a decision and order of the Wisconsin Board of Tax Appeals assessing additional "privilege dividend" taxes against appellant for the period September 26, 1935 to October 15, 1937 in the sum (including interest and penalties) of approximately $70,000.00.

Appellant International Harvester Company is a corporation organized in 1918 under the laws of the State of New Jersey, with its principal office at Hoboken, N. J. The general offices are in Chicago.

This concern is admitted to do business in every state of the union except Nevada. Products of this corporation are nationally known and nationally sold, which is a fact of common knowledge.

No meetings of the directors of the corporation have ever been held in Wisconsin. These meetings always have been held in Chicago. It necessarily follows that the declaration of dividends by the corporation is an act which has occurred only in the State of Illinois and never in the State of Wisconsin.

Of the company's 32,000 stockholders, *ninety-eight per cent* are *non-residents* of Wisconsin, according to the stipulation filed herein.

Upon this basis, the first challenge in the pending lawsuit is to the applicability of Wisconsin's dividend tax law [fol. 168] to this particular foreign corporation.

Literally, the statute itself does not apply.

Sec. 71.60 (3)(1) provides:

"*For the privilege of declaring and receiving dividends*, out of income derived from property located and business transacted in this state, there is imposed a tax. . . ." (Our italics).

"Declaring and receiving."

This corporation does not *declare* its dividends in Wisconsin nor do 98% of its stockholders *receive* dividends in Wisconsin.

Hence, it is argued, the statute does not apply.

Counsel for the appellant however do not expect this court to be so naive as to assume that the challenge is to the mere inapplicability of the statute. The situation in the J. C. Penney case was one of a foreign corporation, declaring dividends *outside* of the state to stockholders located *out* of the state. Yet in that litigation the Penney company finally was beaten.

> State of Wisconsin v. J. C. Penney Company, 311 U. S. 435, 85 L. ed. 267.

The International Harvester Company is not asking us to hold simply that the statute does not apply to it. In substance, it is re-opening and submits that we are entitled to re-open the entire mooted question of the *constitutionality* of the privilege dividend tax law as affecting foreign corporations.

The Supreme Court of Wisconsin, in a 6 to 1 decision, held it unconstitutional, Mr. Justice Fowler dissenting.

> J. C. Penney Company v. Tax Commission, 233 Wis. 286.

The Supreme Court of the United States, in a 5 to 4 decision, held it constitutional, Mr. Chief Justice Hughes, Mr. Justice Roberts, Mr. Justice McReynolds and Mr. Justice Reed dissenting.

> State of Wisconsin et al. v. J. C. Penney Company, 311 U. S. 435, 85 L. ed. 267.

The majority opinion of the Wisconsin court was written by Mr. Chief Justice Marvin B. Rosenberry.

[fol. 169] The majority opinion of the United States court was written by Mr. Justice Felix Frankfurter.

Upon remand from the court at Washington, the Supreme Court of Wisconsin again considered the nature and application and constitutionality of the tax. Mr. Chief Justice Rosenberry again wrote the opinion, which this time was unanimous.

> J. C. Penney Company v. Tax Commission, 238 Wis. 69.

We agree with counsel for the International Harvester Company that an immaculate dilemma has been created.

In the first Penney case the Supreme Court held the tax to be a transaction tax or tax on "privilege", as in terms it so states; and since the transaction happened and the privilege was exercised outside of Wisconsin, in the case of a foreign corporation such as this one, the Wisconsin court held the tax unconstitutional, being violative of due process.

When however this case reached the Supreme Court of the United States, that tribunal regarded this tax as a "supplementary income tax" upon the corporation and hence clearly within the power of the state to impose and not infringing upon the fourteenth amendment.

In the third and final round of the battle thus far, i. e., remand from the United States Supreme Court to the Wisconsin court, our local court followed the United States Supreme Court upon the issue of constitutionality *because it had to do so.* That pithes a delicate point rather abruptly but no one will question the accuracy of our assertion.

The Supreme Court of Wisconsin however, in this last decision, refused to recede from its former position that this was an excise or privilege tax. It militantly maintained that it was its right, and its alone, to say what this tax was; and that such was not the province of the Supreme Court of the United States. And thereupon and in the face [fol. 170] of the highest federal court declaration that the tax here involved was a "supplementary income tax" upon the corporation, the Wisconsin court unequiov-ally declared: "*In no sense and to no extent whatever, is it a tax upon the income of the corporation.*" (Our italics).

J. C. Penney Company v. Tax Commission, 238 Wis. 69, 73.

We can not settle this dispute. That rests far beyond our hands.

The Wisconsin court insists that the tax is a transaction tax, which under the federal constitution makes it unconstitutional because based on out-of-state transactions. But the United States court majority opinion disregards it as a transaction tax and sets the tax up as an additional corporate income tax, the validity of which is obvious.

The Supreme Court of Wisconsin, as noted, however, will not accept it as an income tax on the corporation. Furthermore, it postulates that if it is an income tax on individuals,

it is unconstitutional *under the state constitution,* because the individuals are beyond the jurisdiction of Wisconsin to tax.

"It is perfectly true that the tax cannot be sustained as an income tax under the law of this state."—Thus spoke our own Supreme Court.

J. C. Penney Company v. Tax Commission, 238 Wis. 69, 72.

Therefore, as an income levy, the tax is completely *persona non grata* in this state,—an unwanted black sheep in the Wisconsin court's backyard.

Here then is the deadlock: If the tax is a transaction tax, as Wisconsin's court says it is, then it is void under the *federal* constitution; and the federal court should so hold it. If on the other hand it is an income tax, it can be an income tax only on individuals, according to the Wisconsin [fol. 171] court, and then it becomes void under the *state* constitution; and the state court should so hold it.

One living *fact* however sticks out in this mesh of speculation and expectation and of controversy. And that existing fact controls the Circuit Court for Dane County until the time, if any, when one of the higher courts changes its conclusion as to what this law is.

That salient fact is that both courts—federal supreme and state supreme—*so far* hold the law to be valid.

Whatever may be the refinements of difference as to meaning or designation of the tax, and serious as may be the clash of legal conceptions that *ultimately* may destroy it, the record thus far indicates that the tax must be accepted by lower courts as a valid tax, even as against a foreign corporation declaring its dividends out of the state to stockholders out of the state.

The Supreme Court of the United States *reversed* the decision of the Supreme Court of Wisconsin which had held the tax unconstitutional. That is the record in the federal court.

The Supreme Court of Wisconsin, upon remand, regardless of its frank and emphatic disagreement with the United States court upon the theory of the tax, concludes succinctly:

"It is held that the statute is valid; that the State of Wisconsin has jurisdiction to levy the tax * * *."

J. C. Penney Company v. Tax Commission, 238 Wis. 69, 79.

The next ground for the appeal herein is the alleged unsoundness of the method employed by the Department of Taxation, sustained by the Board of Tax Appeals, in computing the tax. To adopt appellant's own construction of what respondent have done: "Basically in the computation of the tax as affirmed by the Board of Tax Appeals, the Department has attempted to analyze the surplus on the December 31st of the year preceding the year in which a particular dividend is paid, in an alleged attempt to determine the percentage of Wisconsin income in surplus at that time." (Appellant's brief, pp. 5-6).
[fol. 172] Sec. 71.60 (3) (4) reads:

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. *In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend.* If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." (Our italics).

Appellant argues that it has successfully shown that dividends were not paid out of *earnings* attributable to Wisconsin for the immediately preceding year but rather out of its general surplus. Hence, the presumption stated in the foregoing statutory clause, is said to be rebutted; and plainly it is.

The question, as we see it, then becomes: If the presumption of payment out of preceding year's earnings is rebutted, what test may or must the Department of Taxation apply?

Certainly it is not intended that there shall be a gap and that if the presumption is rebutted, there shall be no tax. Yet this in essence is the effect of appellant's argument.

Incidentally, it strikes us that the legislature has proceeded with artificiality in making the basic assumption that dividends customarily are paid out of earnings of the immediately preceding year. We had thought that ordinarily they were paid out of surplus. In predicating the presumption that dividends are paid out of one year's earnings, namely those of the year most recently past, rather than out of the accumulated surplus—unless proven to the contrary—the legislators have visualized the cart before the horse; but perhaps for reasons sufficient to themselves.

Appellant's objection herein is that, the presumption being frustrated, our tax authorities went ahead and determined the portion of the dividend paid out of surplus de- [fol. 173] rived from Wisconsin (using the surplus figure as of the close of the preceding fiscal year). This, it is pointed out, is the method prescribed by 71.60 (3) (4) for a *loss;* and appellant contends that there being no loss but, on the contrary, a profit, then—under the maxim, *enumeratio unius est exclusio alterius*—the tax people have done just what the legislature inferentially said they could not do in the case of a profit.

This presents a fascinating problem, were it not for the circumstance that the Supreme Court of Wisconsin has given sanction to the formula utilized by the Department of Taxation. With that sanction before us, we can not very well pick the mechanics to pieces for theoretical reasons.

Upon remand in the Penney case, the Supreme Court said (J. C. Penney v. Tax Commission, 238 Wis. 69, 78-79):

"When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. *Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus.* The Tax Commission treated the matter as if the statutory presumption were conclusive and gave no weight or consideration to the evidence. In

this the Tax Commission was in error. It is said in briefs of counsel that it would be a Herculean task to compute the amount of surplus attributable to Wisconsin income. Inasmuch as the basis upon which the supreme court of the United States sustained the tax is that some part of the dividend is allocable to Wisconsin income, we see no escape from the conclusion that no tax can be levied until that fact is ascertained." (Our italics).

That the Department of Taxation in the present case has acted in pursuance of Mr. Chief Justice Rosenberry's analysis, is not and can not be disputed by appellant.

On page 11 of the brief by appellant's attorneys, they say: "There is no such thing as a Wisconsin surplus. It is therefore a gratuitous assumption, unwarranted under the statute, to declare that when the company pays a dividend, it draws on Wisconsin earnings in the proportion that [fol. 174] Wisconsin earnings reflected in surplus bear to its total surplus."

On page 4 of the reply brief by appellant's attorneys, they say: "The only manner in which it can be said that the dividend, which was actually paid out of surplus, was partially paid out of Wisconsin earnings reflected in surplus, is to adopt a new fiction in lieu of the rebutted statutory fiction."

These comments might constitute a well-des-rved rebuke to the Department of Taxation, were it not for the fact that the opinion of Mr. Chief Justice Rosenberry, evidently concurred in by all the justices, points the way to what appellant calls the "unwarranted" assumption and "new fiction".

If the merits need be considered, which they need not, since the Chief Justice and the court have spoken;

Why is it not completely logical to state, as Mr. Chief Justice Rosenberry did, that when the corporation drew upon surplus containing Wisconsin income, it drew upon Wisconsin income to the extent of the proportion of that income to the whole amount of the surplus?

Moreover, as we have intimated, if this foundation is not built upon, then upon what can the Department of Taxation construct any tax whatever? And surely because a presumption is rebutted, it should not be contemplated that the bottom drops out of the tax bucket.

We repeat: Appellant's position renders the whole dividend tax nugatory. Bluntly its attorneys state (p. 7, reply brief): "Finally, there is not a word in the statute which says that a dividend paid out of surplus can be taxed. The statute provides for taxing only dividends paid out of income."

If this is the end result of Wisconsin's dividend tax law, then that law is a dead letter, not only as to foreign corporations *but as to domestic corporations as well,* which [fol. 175] declare dividends out of surplus. And we know that corporations do declare dividends out of surplus. A second-year law school student knows that. The law of corporations just about requires it, both as to a New Jersey corporation such as appellant and as to a Wisconsin corporation.

Section 14: 8-19, Revised Statutes of New Jersey 1937, provides:

"*The directors of a corporation shall not pay dividends except from its surplus,* including surplus as determined by section 14: 8-6 of this title, or from the net profits arising from the business of the corporation. * * *" (Our italics).

Sec. 182.19 (1), Wisconsin statutes, reads:

"No dividend shall be paid by any corporation until at least fifty per cent of the authorized capital stock has been fully paid in, *and then only out of net profits properly applicable thereto* * * *"

We grant that appellant has an academic argument to the effect that it has rebutted the presumption that dividends were paid out of the preceding year's earnings and that the statute does not call for a tax on dividends declared out of surplus, *eo nomine.*

But in that event, what was the sense in carrying the issue of *constitutionality* in the first Penney case to the Supreme Court of the United States? The whole matter could have been stopped in its tracks by a decision of the Wisconsin court that the statute does not tax dividends declared out of surplus.

What was the purpose of the Supreme Court of Wisconsin in the second Penney case in sending the case back to the Department of Taxation for a re-computation, if the law does not tax a dividend declared out of surplus? Our Supreme Court knew that the dividend of J. C. Penney Com-

pany was declared out of *surplus*. The entire second phase of its opinion was devoted to that very proposition. (238 Wis. 69, 74-79).

To now propound, as appellant does, that a dividend out of surplus is not taxable at all, is to accuse the legislature of futility and the Supreme Court of a glaring oversight.

[fol. 176] Appellant's incidental criticism in this regard is that the Department of Taxation should not have used surplus *as of December* 31st of the year preceding. Appellant submits directors' resolutions which purportedly recognize something in the form of a current or daily surplus, e. g., "surplus account at April 15, 1937."

This approaches the hyper-critical. Common business sense dictates that surplus figures may be taken as of the close of the year. One cannot mark a surplus sheet like the milk man's morning card.

Finally, appellant protests of the retroactivity of the computation. That is, this surplus is an accrual from the year 1918. It can not be segregated as to time. *Ergo*, says appellant, this surplus allocation method must be erroneous to the extent that it presupposes surplus accretions *before* Wisconsin's dividend tax law ever went into effect, which was September 26, 1935. Erroneous, because appellant argues, the taxpayer had met all of Wisconsin's requirements as to income earned prior to that date and could not constitutionally have thrust upon it an additional burden upon that income—citing the dissenting opinion of Mr. Justice Roberts in the Penney case.

This argument is a throw-back to the original dilemma herein described. If the tax is geared to income, then it is arguable that we are faced with a prodigiously retroactive income tax. On the other hand, if the tax is a transaction tax, then the argument mis-fires; for the *transaction* is a present one, to-wit, the immediate declaration of the dividend; and the hoary surplus is but one component in the equation by which to gauge the final quantum of the tax.

We respectfully leave that residuum of the dilemma where it belongs: To our colleagues on the Supreme Court of Wisconsin and the Supreme Court of the United States.

The Attorney General may prepare and submit to appellant's attorneys the order and judgment affirming the decision and order of the Board of Tax Appeals.

Dated August 14, 1942. (10)

[fol. 177] IN CIRCUIT COURT OF DANE COUNTY

INTERNATIONAL HARVESTER COMPANY, Petitioner

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

JUDGMENT—September 17, 1942

The above proceeding commenced by the International Harvester Company, a New Jersey corporation, pursuant to the provisions of sec. 73.015 Wis. Stats. 1941, to review the decision and order of the Wisconsin Board of Tax Appeals dated February 13, 1942 modifying, and affirming as so modified, an additional assessment of Wisconsin privilege dividend taxes against said International Harvester Company, for the period September 26, 1935 to October 15, 1937, inclusive, having been heard before the Court on the record made before the Wisconsin Board of Tax Appeals in accordance with the provisions of sec. 73.015 (5) Wis. Stats. 1941, R. M. Stroud of Madison, Wisconsin and Edward R. Lewis of Chicago, Illinois, appearing for the petitioner International Harvester Company and John E. Martin, Attorney General of Wisconsin by Harold H. Persons, Assistant Attorney General appearing for the respondent, and the Court, after hearing the arguments of counsel, reading the briefs submitted, and fully considering the case, having rendered a written opinion dated August 14, 1942, and entered an order directing judgment affirming the said additional assessment as modified, and affirmed as so modified, by the said decision and order of the Wisconsin Board of Tax Appeals, and confirming the said decision and order of the Wisconsin Board of Tax Appeals dated February 13, 1942; and

[fols. 178-179] Notice of application for the entry hereof having been duly waived in writing by the attorneys for the petitioner International Harvester Company, on motion of John E. Martin, Attorney General of Wisconsin by Harold H. Persons, Assistant Attorney General,

It is hereby ordered and adjudged that the additional assessment of privilege dividend taxes against the International Harvester Company, a New Jersey corporation, for the period September 26, 1935 to October 15, 1937, inclusive, as modified and affirmed as so modified, by the

decision and order of the Wisconsin Board of Tax Appeals dated February 13, 1942 is hereby affirmed; and

It is hereby further ordered and adjudged that the decision and order of the Wisconsin Board of Tax Appeals dated February 13, 1942, modifying, and affirming as so modified, the said additional assessment of privilege dividend taxes against the International Harvester Company, a New Jersey corporation, is hereby confirmed in all respects; and

It is hereby further ordered and adjudged that the respondent, Wisconsin Department of Taxation have and recover of the said International Harvester Company the sum of ($——) costs (balance of unpaid clerk's fees to be taxed and inserted herein by the Clerk if the same are not paid by the petitioner International Harvester Company).

Dated at Madison, Wisconsin this 17th day of September, 1942.

By the Court (Signed) Alvin C. Reis, Circuit Judge.

[fol. 180] IN SUPREME COURT OF WISCONSIN

EXCERPTS FROM APPELLANT'S BRIEF

Proposition "II" at page 30:

"II

Taxation without jurisdiction is a denial of due process, and a privilege or excise tax cannot be levied for the privilege of doing acts which are actually done outside the jurisdiction. Such due process is guaranteed by the Fourteenth Amendment of the Federal Constitution, as well as by the Wisconsin Constitution. The Privilege Dividend Tax Law as here applied, and the taxes assessed thereunder and sustained below, violate such due process and the rights of appellant and of its stockholders under the Federal Constitution."

Proposition "III" at page 33:

"III

The presumption adopted in the assessment in question, namely, that the International Harvester Com-

pany paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business reflected in surplus, bore to its total surplus, is wholly unauthorized by the statute."

[fol. 181] Proposition "IV" at page 38:

"IV

Where a statute provides a method of allocation and does not clearly grant to the Tax Commission authority to supply a formula in case the statutory formula proves unworkable or unconstitutional in the case of the particular taxpayer involved, the Tax Commission has no authority to supply a formula of its own. The Wisconsin Department of Taxation, therefore, has no authority to apply the formula based on surplus derived from Wisconsin."

Proposition "V" at page 40:

"V

The State of Wisconsin cannot tax any dividend which was derived from earnings accumulated prior to September 26, 1935, when the Wisconsin Privilege Dividend Tax took effect."

[fol. 182] In Supreme Court of Wisconsin

International Harvester Company, Appellant

vs.

Wisconsin Department of Taxation, Respondent

Dane Circuit Court

Minute Entry of Argument and Submission—March 10, 1943

And now at this day came the parties herein, by their attorneys, and this cause having been argued by R. M. Stroud, Esq., and Edward R. Lewis, Esq., for the said appellant, and by Harold H. Persons, Esq., Assistant Attorney General, J. Ward Rector, Esq., Assistant Attorney Gen-

eral, and Richard H. Teschner, Esq., for the said respondent, and submitted, and the court not being now sufficiently advised of and concerning its decision herein, took time to consider of its opinion.

[fols. 183-184] IN SUPREME COURT OF WISCONSIN

INTERNATIONAL HARVESTER COMPANY, Appellant

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

Dane Circuit Court

Opinion by Justice Wickhem

JUDGMENT—June 16, 1943

This cause came on to be heard on appeal from the order and judgment of the Circuit Court of Dane County and was argued by counsel. On consideration whereof, it is now here ordered and adjudged by this Court, that the order and judgment of the Circuit Court of Dane County, appealed from in this cause, be, and the same are hereby, affirmed.

Justice Barlow took no part.

[fol. 185] IN SUPREME COURT OF WISCONSIN, JANUARY TERM, 1943

No. 56

INTERNATIONAL HARVESTER COMPANY, a New Jersey Corporation, Petitioner and Appellant

v.

WISCONSIN DEPARTMENT OF TAXATION, Respondent

OPINION—Filed June 16, 1943

This is an appeal from an order and judgment of the Circuit Court for Dane County, Alvin C. Reis, Circuit Judge. *Affirmed.*

Appeal to the Circuit Court for Dane County from an order of the Wisconsin Board of Tax Appeals which had

affirmed an additional assessment of privilege dividend taxes against appellant, International Harvester Company, a New Jersey Corporation. The order of the Wisconsin Board of Tax Appeals was dated February 13, 1942 and the order and judgment of the Circuit Court was made and entered on September 17, 1942. The material facts will be stated in the opinion.

[fol. 186] WICKHEM, J.:

Appellant is a New Jersey corporation, having its principal office in Hoboken, New Jersey. Its general executive offices are in Chicago. So far as the record discloses, it has done business in Wisconsin since 1920. The Wisconsin dividend privilege tax law was enacted and went into effect on September 26, 1935. From December 2, 1935 to October 15, 1937 appellant paid numerous dividends totalling $39,028,188.22, but did not pay any privilege dividend tax thereon. As of the end of the year 1934, the amount of surplus accumulated from Wisconsin earnings and constituting Wisconsin surplus on the basis of the formulae and method of computation prescribed by chapter 71 was $803,780.72. The amount attributable to Wisconsin as of December 31, 1935 was $2,227,499.03. The Wisconsin surplus as of October 31, 1936 was $2,608,908.26. On December 2, 1937 the Wisconsin Tax Commission, predecessor of Wisconsin Department of Taxation, notified appellant of an assessment of privilege dividend tax against it in the amount of $68,838.49, exclusive of penalties and interest, computation being based upon the statutory presumption that such dividends were paid out of previous years' earnings. Subsequently thereto, and because of the conceded rebuttal of the presumption, respondent recomputed the privilege dividend tax at $53,713.29, exclusive of penalties and interest. There is a stipulation to the effect that, assuming the law to be valid and the method of computation authorized, the amount of the privilege tax as computed is correct. The contentions made by appellant all present matters of constitutional law and statutory construction. It is contended that the privilege dividend tax contravenes the due process provision of the Wisconsin constitution and of the federal constitution; that the computation [fol. 187] adopted by the Wisconsin Department of Taxation is not authorized by the Wisconsin dividend privilege

tax law, but on the contrary, that the dividend tax law prescribes a wholly different formula; that this was not followed by the Tax Department; that Wisconsin may not tax the privilege of declaring and receiving dividends derived from earnings accumulated prior to the date when the Wisconsin dividend tax took effect.

This case is another chapter in a long history of litigation concerning the dividend tax law during which this court has passed upon the constitutionality of the law and its proper construction three times, and the United States Supreme Court has considered these matters once. *Froedtert G. & M. Co. v. Tax Comm.*, 221 Wis. 225, 265 N. W. 672, 267 N. W. 52; *J. C. Penney Co. v. Tax Comm.*, 233 Wis. 286, 289 N. W. 677; *Wisconsin v. Minn. Mining & Mfg. Co.*, 311 U. S. 452; *J. C. Penney Co. v. Wisconsin*, 238 Wis. 69, 298 N. W. 186, (upon remand).

The controversy has developed into a battle of words and labels and it may be of service to review the litigation and ascertain just what has been authoritatively determined. On September 26, 1935 the privilege dividend tax[1] went into effect and for purposes of reference so much of it as is material here is set forth in the notes. The constitutionality and construction of this law was put in issue in *Froedtert G. & M. Co. v. Tax Comm.*, (supra) and this court there held that it levied a tax upon the privilege of transferring from the corporation to the stock holders corporate net income derived from corporate business transacted, or property located in Wisconsin. That case involved a Wisconsin corporation, but upon rehearing, it was stated without elaborate discussion that the tax was constitutional as applied to the dividends of foreign corporations. The matter again came before this court in *J. C. Penney Co. v. Tax Comm.*, 233 Wis. 286, 289 N. W. 677, and it was there held that in its application to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin, the law was an unconstitutional at- [fol. 188] tempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax. This court relied principally on the case of *Connecticut Gen. Ins. Co. v. Johnson*, 303 U. S. 77, where upon facts that appeared to

[1] Reporter will publish sec. 71.60, statutes of 1941, section 3, (1), (2), (3) and (4), as a foot note.

us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax, and in doing so, had said:

"But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state."

Upon appeal to the United States Supreme Court, judgment in the *Penney* Case was reversed by a divided Court. It was held that the practical operation of the legislation is to impose an additional tax upon corporate earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends.

"In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."

After noting that the act specifically levies the tax upon the privilege of declaring and receiving dividends, that the taxpayer is a Delaware corporation with its principal offices and meeting place in New York, and that this court has held the tax to be one upon a transaction wholly beyond Wisconsin's borders or reach, the Court said:

"The case thus reduces itself to the inquiry whether Wisconsin has transgressed its taxing power because its supreme court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax on the privilege of declaring dividends rather than a supplementary income tax.

"A tax is an exaction. Ascertainment of the scope of the exaction—what is included in it—is for the state court. But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction * * *."

"* * * For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A [fol. 189] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to

opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society."

"Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. 'Taxable event,' 'jurisdiction to tax,' 'business situs,' 'extraterritoriality,' are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state."

Upon remand to determine such questions as were left open by the opinion of the Supreme Court, this court in *J. C. Penney Co. v. Tax Comm.*, 238 Wis. 69, 298 N. W. 186 (1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called, and (4) made certain directions as to its computation. The latter point need not be elaborated in this portion of the opinion. From the briefs in this case, and the memorandum of the trial court it appears to be concluded that we have here what the trial court designates an "immaculate dilemma;" that the Supreme Court of the United States has held this to be an income tax and that as such, it is invalid under the Wisconsin constitution; that the Supreme Court of Wisconsin, upon remand has persisted in designating it a privilege tax in which case the privilege being wholly exercised outside of the state, it is unconstitutional under the federal constitution.

We see no such dilemma. As we read the opinion of the United States Supreme Court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned. What the Su-

[fol. 190] preme Court has done is (1) to state the factual basis upon which this law must be treated as constitutional insofar as the jurisdiction of Wisconsin to levy it is concerned and (2) to hold that given the factual basis, the law is constitutional in this aspect, regardless of the designation given it by this court. In other words, the federal Supreme Court has established the judisdictional fact which is that the corporation paid the dividends in whole or in part out of property located in this state, or business transacted here. If the term "jurisdictional fact" must hereafter be relegated to the limbo of outmoded terms, the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from this activity are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the Supreme Court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.

This being true, we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction. It makes no difference what this court calls the tax. It may, for other than constitutional reasons, be important to designate the tax a privilege tax, but the label has no bearing upon the controversy here. We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. Under the circumstances, we do not propose to re-examine contentions heretofore made and impliedly overruled that the law is void under the Wisconsin constitution. The constitutional question considered material and decided by this court in the original *Penney* Case involved the [fol. 19] federal constitution and has been answered by the Supreme Court. We consider the matter to be closed.

The next question has to do with the application and computation of the tax, and in connection with this a constitutional question is raised having to do with its restrospective operation and not litigated or involved in the previous liti-

gation. From even a casual reading of the privilege dividend tax, it is clear that the legislature meant to levy it upon the paying out and receiving of dividends out of net corporate earnings in Wisconsin, without regard to the year or years during which the earnings accrued. Subsection 3 of section 71.60 Stats. provides without qualification that the tax shall be levied for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in this state. Subsection 3(4) provides "in the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only on dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin." (Income attributable to this state to be computed in accordance with the provisions of chapter 71.)

"• • • In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. • • •"

This merely creates a rebuttable presumption that all of the dividend was paid out of Wisconsin earnings for the year immediately preceding the payment of the dividend. It is finally provided that if the corporation had a loss for that year the commission, upon application, is to determine the portion of such dividend paid out of surplus and undivided profits derived from business transacted, and property located within the state. There is no time limit anywhere unless the reference to the presumption be tortured into some sort of limitation of the tax to dividends paid out of the previous years' earnings and this would be a disingenuous construction. The section strongly suggests that the legislature had no misgivings as to its power to [fol. 192] reach Wisconsin earnings without regard to the time of their accrual by a tax on the privilege of paying and receiving dividends effecting their distribution.

Upon the question whether, so far as it purports to reach Wisconsin earnings without reference to the year in which they were earned, the section is unconstitutionally retroactive in application, the Court is equally divided.

Mr. Justice Fowler, Mr. Justice Fritz and Mr. Justice Fairchild are of the view (1) that since this is a privilege

tax on transactions by which dividends are declared and paid subsequent to the enactment of the statute, the tax is prospective and not retroactive in operation when it is imposed on only such of those transactions as occurred in the year in which it is imposed; (2) that the prospective character of the tax is not affected by the fact that in assessing the amount thereof,—which under the statute is to be limited to the extent that income earned in Wisconsin was used in paying the dividend in such year,—there was included undistributed income earned theretofore in Wisconsin; and (3) that these conclusions are in accord with the decision of this court upon remand in the *Penney* Case.

Mr. Chief Justice Rosenberry, Mr. Justice Martin and the writer are of the view (1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to "recent" transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the [fol. 193] enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion.

The court being equally divided, this results under the rules of this court in an affirmance of the judgment upon this point.

The rest of this case we consider to have been authoritatively settled by the decision of this court in the *Penney* Case upon remand. The law requires that the commission assess the tax upon the presumption that the dividend was paid out of Wisconsin earnings for the year preceding the declaration of a dividend. Upon rebuttal of this presumption, a tax may be levied upon such portion of the dividend

as is represented by Wisconsin earnings, these to be ascertained by application of the formula prescribed in Chapter 71. The proportion between the sum so arrived at and the total assets available for dividends establishes the percentage of the dividend attributable to Wisconsin earnings. In the *Penney* Case upon remand this Court said:

"• • • When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus. • • •"

In making this statement it was not intended to create an artificial rebuttable presumption comparable to that created in sub-section (4) of the dividend tax act. What the court meant to hold and what we do hold is that in this situation there is a strong, if not inevitable inference to the effect noted. In other words, that the conclusion not only can be arrived at by ordniary methods of reasoning without dependence upon a judicially created presumption, but that it cannot be avoided by any evidence that we have presently in mind.

It is contended that since the statute contains no specific formula for computing the tax, this Court cannot supply [fols. 194-195] one. We deem this contention unsound. If by any process reasonably calculated to accomplish the result, the amount of Wisconsin earnings involved in the declaration sought to be taxed may be ascertained the validity of the law is not impaired by the absence of detailed specifications concerning computation. The formula for ascertaining the amount of net earnings allocable to Wisconsin is set forth in chapter 71 and the validity of this formula is well established. There is a strong if not inevitable inference that these earnings became (1) part of the general assets available for distribution as dividends, and (2) part of the dividend declared in the proportion that they bear to the total assets available for dividends. We do not deem

it necessary that there shall have been a formal transfer of earnings into a surplus account. While the statutes of New Jersey, and we suppose those of nearly every state, require that dividends be paid out of surplus, the sense in which surplus is used means excess of assets over liabilities, including capital. This concern of the law as laid down by decisions and prescribed by statutes is that dividends shall not be declared out of capital. If Wisconsin earnings have gone to swell the assets of the corporation in such a way as to create an excess of assets over liabilities, and to authorize a dividend, the Wisconsin earnings are proportionately a part of this excess, whatever it be called. The formula prescribed by this court upon remand in the *Penney* Case, that is, that the Wisconsin earnings should constitute the numerator of a fraction of which the entire amount available for dividends is the denominator, is rational and workable and was applied in this case. While we recognize the force of objection that can be made to any determination reached in this matter, the foregoing conclusions are the only ones that will accommodate themselves to premises which we must accept.

By the Court.—Order and judgment are affirmed.

[fol. 196] IN SUPREME COURT OF WISCONSIN

[Title omitted]

MOTION FOR REHEARING—Filed July 3, 1943

Now comes International Harvester Company, the above named Petitioner and Appellant, and in accordance with Rule 37 of this court respectfully moves the court for a rehearing of its decision and mandate filed herein on the 16th day of June, 1943, for reasons which will be set forth in the printed argument to be filed in support hereof.

Dated this 3rd day of July, 1943.

International Harvester Company, By Edward R. Lewis, Stroud, Stebbins & Wingert, Its Attorneys.

[fol. 197] IN SUPREME COURT OF WISCONSIN

EXCERPTS FROM APPELLANT'S BRIEF IN SUPPORT OF MOTION FOR REHEARING

Heading appearing at page 1:

"If this court remains irreconcilably divided on the question whether the privilege dividend tax law is fatally retroactive, it should in any event state whether the determination of that issue involves the Wisconsin Constitution, the Federal Constitution, or both."

Heading "B" at page 10:

"B. The privilege dividend tax, even if otherwise valid, insofar as it operates to impose taxes on the distribution of earnings accumulated prior to date of enactment is retroactive and violative of the due process provisions of Sections 1 and 9 of Article 1 of the Wisconsin Constitution and the Fourteenth Amendment of the Constitution of the United States."

Heading appearing at page 11:

"The Formula adopted by the Wisconsin Department of Taxation is a denial of due process of law."

Heading appearing at page 16:

"The privilege dividend tax on the whole violates the due process provisions of the Wisconsin Constitution and the Fourteenth Amendment of the Federal Constitution."

[fol. 198] IN SUPREME COURT OF WISCONSIN

[Title omitted]

ORDER RETAINING RECORD—July 3, 1943

The said appellant having moved for a rehearing in this cause, it is now here ordered that the record be retained in this Court until the final determination of said motion.

[fols. 199-200] IN SUPREME COURT OF WISCONSIN

[Title omitted]

ORDER DENYING MOTION FOR REHEARING—September 14, 1943

The Court being now sufficiently advised of and concerning the motion of the said appellant for a rehearing in this cause, it is now here ordered that said motion be, and the same is hereby, denied with $25.00 costs.

[fol. 201] IN SUPREME COURT OF WISCONSIN

[Title omitted]

OPINION ON REHEARING—Filed September 14, 1943

WICKHEM, J. on re-hearing:

The court has thoroughly considered the motions for rehearing filed herein and is not disposed to modify its views or to restate or amplify its opinion in any respect but one. In discussing the permissible retroactivity of the privilege dividend tax and noting an equal division of the court upon that point, the opinion did not indicate whether the difference in view was based upon the constitution of the state of Wisconsin, the constitution of the United States of America, or both. It may be useful to state that the constitutionality of the law in this respect was considered under both; and the court was of the view that the same considerations governed whichever constitution was applied.

By the court—Motion for re-hearing is denied, with $25 costs.

[fol. 202] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 203] IN THE SUPREME COURT OF THE UNITED STATES

APPELLANT'S STATEMENT OF POINTS TO BE RELIED UPON AND DESIGNATION OF PARTS OF RECORD TO BE PRINTED.—Filed January 24, 1944

Now comes International Harvester Company, the above named Appellant, pursuant to Rule 13, paragraph 9, of the Rules of the Supreme Court of the United States, and states that the points on which it intends to reply in this Court in the above entitled matter are as follows:

(1) The Supreme Court of Wisconsin erred in failing to hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, as applied to International Harvester Company, a New Jersey corporation, and its stockholders, especially the non-residents of Wisconsin, under the undisputed facts of the case, was invalid because in effect an imposition of a tax on transactions beyond the State's jurisdiction and hence repugnant to the Fourteenth Amendment of the Constitution of the United States.

(2) The Supreme Court of Wisconsin erred in failing to hold that the assessments of taxes involved in this matter, purporting to have been made in pursuance of the provisions of Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, against International Harvester Company, a New Jersey corporation, under the undisputed facts, operated to take the property of Appellant and of its stockholders, especially the non-residents of Wisconsin, without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

(3) The Supreme Court of Wisconsin erred in failing affirmatively to determine and hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, and the assessments of taxes thereunder against Appellant, insofar as the same operated or were applied to tax the distribution of income or profits of Appellant derived and accumulated prior to the enactment of that law, deprived Appellant and its stockholders of property without due

process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

[fol. 204] Appellant further states that for the consideration of the above entitled matter it will be necessary for the Clerk of said Court to cause to be printed the entire record as filed in this Court, except only the following portions thereof:

Copy of Appeal Bond (Rec. p. 84-85)
Citation (Rec. p. 86)

Notice of Application for Entry of Judgment in Circuit Court for Dane County. (Rec. p. 179)

Respectfully Submitted, John A. Kratz, 1001 Fifteenth St. N. W., Washington, D. C.; Edward R. Lewis, 180 N. Michigan Ave., Chicago, Ill.; Ray M. Stroud, 1 W. Main St., Madison, Wis. Attorneys for Appellant.

Stroud, Stebbins & Wingert, Of Counsel.

Service of the foregoing Statement and Designation this 21st day of January, 1944, is hereby admitted.

John H. Martin, Attorney General for the State of Wisconsin. By Harold H. Evans, Assistant Attorney General for the State of Wisconsin. Attorneys for Appellee.

[fol. 204a] [File endorsement omitted]

[fol. 205] Supreme Court of the United States

Order Noting Probable Jurisdiction—February 28, 1944

The statement of jurisdiction in this case having been submitted and considered by the Court, probable jurisdiction is noted.

[Endorsed:] File No. 48,113 Wisconsin, Supreme Court. Term No. 620. International Harvester Company, Appellant, vs. Wisconsin Department of Taxation. Filed January 21, 1944. Term No. 620 O. T. 1943.

FILE COPY

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

STATEMENT AS TO JURISDICTION.

JOHN A. KRATZ,
EDWARD R. LEWIS,
RAY M. STROUD,
Counsel for Appellant.

STROUD, STEBBINS & WINGERT,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

STATEMENT AS TO JURISDICTION.

Pursuant to the provisions of Rule 12 of the Supreme Court of the United States, Appellant files this statement, showing that this Court has jurisdiction upon appeal to review the judgment in question.

This is an appeal from the judgment of the Supreme Court of the State of Wisconsin in the cause of *International Harvester Company, Appellant,* v. *Wisconsin Department of Taxation, Respondent,* reported in 243 Wis. 198, 10 N. W. 2d 169, and on rehearing in 11 N. W. 2d 95, wherein the Supreme Court of Wisconsin affirmed the order and judgment of the Circuit Court for Dane County, Wisconsin, which order and judgment affirmed an order of the Wisconsin Board of Tax Appeals which in turn had affirmed an assessment of Wisconsin privilege dividend taxes

against Appellant, International Harvester Company, a New Jersey corporation. Copy of the decision and order of the Wisconsin Board of Tax Appeals is appended hereto as Appendix A. Copy of the decision of the Circuit Court for Dane County is appended as Appendix B. Copy of the decision of the Supreme Court of the State of Wisconsin and of the opinion of the last mentioned court on rehearing are appended as Appendix C.

Copy of opinion of the Supreme Court of the State of Wisconsin in *Wisconsin Gas and Electric Company* v. *Wisconsin Department of Taxation*, a companion case to *International Harvester Company* v. *Wisconsin Department of Taxation*, is also appended as Appendix D. Copy of opinion of Wisconsin Supreme Court in *Blied* v. *Wisconsin Foundry & Machine Company*, also a companion case, is appended as Appendix E.

Basis of Jurisdiction.

Section 237 of the Judicial Code (28 U. S. C. A. 344) gives jurisdiction for this appeal. It provides that a final judgment or decree in any suit in the highest court of a state in which a decision in the suit could be had, where is drawn in question the validity of the statute of any state, on the ground of its being repugnant to the constitution of the United States, and the decision is in favor of its validity, may be reviewed by the Supreme Court by writ of error. By Act of January 31, 1928, Chapter 14, section 1 (28 U. S. C. A. 861a) the remedy by appeal has been substituted for writ of error in such cases.

The State Statute Involved.

The statute of the State of Wisconsin, the validity of which as applied to Appellant is here drawn in question, known as the Wisconsin Privilege Dividend Tax Act, is

section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937. It was published and became effective September 26, 1935. The pertinent provisions of the Act, in effect from date of enactment through 1937, appearing under section 71.60, page 1040, Wisconsin Statutes of 1937, are as follows:

"SECTION 3. PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to 2½ per cent of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1939. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such cor-

poration attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

. . . . . .

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

. . . . . .

(10) Except as they are inconsistent with this section, the provisions of paragraph (b) of subsection (3) of section 71.06, sections 71.10 to 71.17, inclusive, subsection (3) of section 71.18, sections 71.36 and 71.37 of the statutes shall apply to the tax imposed by this section, but the discount provisions of paragraph (c) of subsection (3) of section 71.10 shall not apply."

Date of Judgment Sought to Be Reviewed and Date of Presentation of Application for Review.

The date of the final decision (on motion for rehearing) and judgment of the Supreme Court of the State of Wisconsin sought to be reviewed is September 14, 1943. The original judgment and decision of the Supreme Court of Wisconsin was rendered June 16, 1943.

The petition for appeal to the United States Supreme Court was presented to and allowed by Hon. Marvin B.

Rosenberry, Chief Justice of the Supreme Court of Wisconsin, on December 11, 1943.

Finality of Judgment.

The Supreme Court of Wisconsin is the highest court of the State of Wisconsin, and on its denial of the motion for rehearing its judgment became final. Under the constitution of Wisconsin the Supreme Court of Wisconsin is the court of last resort in the state (Constitution of the State of Wisconsin, Art. VII, Sec. 3).

The United States Supreme Court has held that the date from which the time for making application for appeal begins to run is the date, if a petition for rehearing is filed, when the petition for rehearing is denied. *Citizens Bank of Michigan City v. Opperman*, 249 U. S. 448, 449, 63 L. Ed. 701; *Gypsy Oil Co. v. Leo Bennett Escoe* (572), 275 U. S. 498, 499, 72 L. Ed. 393.

Nature of the Case.

This appeal involves, *in the light of new developments in the application of the law*, (1) the validity of the Wisconsin Privilege Dividend Tax Act (set forth at page 17 hereof) as applied in assessments against Appellant, a New Jersey corporation, in respect to the exercise, wholly outside of Wisconsin, of the privileges of "declaring and receiving" dividends between October 7, 1935, and October 15, 1937; (2) the validity of that law as applied to such dividends declared and paid by Appellant out of income accumulated prior to the date of the enactment of the law; and (3) whether the use of the formula for ascertaining the tax, newly devised and here applied by the Wisconsin Department of Taxation, denies due process of law.

The Wisconsin Privilege Dividend Tax Act imposes a tax at the rate of 2½% (now 3%) "for the privilege of

declaring and receiving dividends out of income derived from property located and business transacted in" Wisconsin. This tax is imposed on dividends declared and paid by all corporations, foreign and local (with exceptions not here pertinent). The Act was to "take effect upon passage and publication" on September 6, 1935; it was applied by way of assessment in respect to all dividends declared and paid by Appellant subsequent to such date, notwithstanding a substantial part of the so-called Wisconsin surplus (accumulated Wisconsin income) from which such dividends were declared and paid had been accumulated prior to the enactment of the law. (Rec. 147).

Since January 1, 1936, Appellant has been admitted to do business in every state of the Union, except Nevada. It had manufacturing plants and sales branches in many states. The proceeds of all sales and receipts from its operations and business went to Appellant's treasury department in Chicago, Illinois, and were there commingled without segregation or ear-marking, in the general funds of the corporation. (Rec. 129).

Every act and proceeding in respect to the declaration and payment of all dividends in question took place in Chicago, Illinois, where Appellant's Board of Directors met and declared them and where Appellant's treasury department drew and mailed dividend checks on Appellant's bank accounts representing its general funds on deposit in Chicago and New York. (Rec. 130, 131). Such dividend checks were there mailed to Appellant's many stockholders, of whom during the period in question there were more than 32,000 in every state of the United States and many foreign countries. Less than 2% of Appellant's stockholders were residents of Wisconsin. (Rec. 131, 150).

Appellant had outstanding both common stock and preferred stock on which it paid dividends quarterly. (Rec. 129). Appellants's dividends were not charged against the

earnings or profits of any particular class or period, but were charged against surplus which resulted from and reflected the accumulated net profits and income from property wherever located and business wherever transacted (Rec. 131). Appellant's charter state is New Jersey, and the applicable laws of that state permit directors of a corporation to pay dividends only from its surplus or from the net profits arising from the business of the corporation, which has been held to be the same as surplus (Rec. 128, 129).

In prescribing the method for determining the amount of "dividends declared and paid out of income derived from property located and business transacted within the State of Wisconsin" by a corporation doing business within and without the state the Dividend Tax Act prescribed that "the amount of income attributable to this state shall be computed in accordance with the provisions of Chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend." Chapter 71, which is the Wisconsin Income Tax Law, prescribes the method for determining taxable income of a corporation engaged in business within and without the state, and in that respect requires attribution of certain non-apportionable income, and the apportionment of the balance on the basis of the arithmetical average of three fractions representing, respectively, the ratios of tangible property, of cost of manufacturing, and of sales in Wisconsin to the total of each. (Sec. 71.02(3) (d) Wis. Stats.)

The Wisconsin Supreme Court, on remand of the *J. C. Penney* case from this court, (*J. C. Penney Co. v. Wisconsin*, 238 Wis., 69, 78, 298 N. W., 186), found that the Penney Company had paid its dividends out of surplus as of the

end of the prior year rather than from income of that year, and thereupon declared that, "It must be presumed, however, that when it (the Company) drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935, but to the whole amount of the surplus." Accordingly, and solely upon the authority of the above quoted language of the Wisconsin Supreme Court, the Wisconsin Department of Taxation proceeded to compute the Wisconsin Privilege Dividend taxes against Appellant on a new formula not provided in the statute (Rec. 144).

It found for each year the percentage of Appellant's net income subject to Wisconsin *income tax*. This was found under the formula specified in Chapter 71, the Income Tax Chapter. It applied that percentage to the Appellant's *book income* for the same year (Rec. 113, 149). Book income, of course, is a very different figure, from taxable income. For one thing, reserves are deducted in arriving at book income which cannot be deducted in arriving at taxable income.

By this method, the Department found the *book income* of Appellant derived from Wisconsin in the year in question. This *book income* derived from Wisconsin, was accumulated from year to year. The amount so accumulated was called Wisconsin earnings reflected in *surplus*. When a dividend was declared the Department estimated that so much of the dividend was derived from Wisconsin earnings as was found by applying to the dividend the ratio obtained by dividing so-called Wisconsin earnings reflected in surplus by total surplus (Rec. 113, 149).

The result was taxed at 2½% (Rec. 146).

The only method prescribed by the statute would have required the Department to apply to the amount of the dividend the income tax fraction of the previous year ob-

tained as the arithmetical average of the ratios of Wisconsin property to total property, Wisconsin sales to total sales, and Wisconsin cost of manufacturing to total cost of manufacturing.

The Wisconsin Department of Taxation included in total surplus on which the tax was calculated, Appellant's surplus at the end of the year 1934, preceding the date (September 26, 1935) of the enactment of the Privilege Dividend Tax, amounting to $803,780.72. This figure had been increased by December 31, 1935, following the enactment of the law, to $2,227,499.03 (Rec. 147). It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26, 1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law.

On the foregoing basis the Wisconsin Department of Taxation applied and assessed against the Appellant the 2½% on its dividends declared and paid between December 2, 1935, and October 15, 1937. The tax amounted to $53,713.29, to which there was added penalties and interest to January 1, 1942, of $16,735.60, bringing the aggregate tax, interest and penalties to $70,088.89, all of which are involved on this appeal (Rec. 146, 167). The assessment was made against Appellant after its payment of the dividends to which applicable, and was paid by Appellant under protest. No part of the tax was withheld from dividends. This suit was brought to obtain refund of the amount so paid.

On this factual basis the Wisconsin Supreme Court affirmed the assessments of privilege dividend taxes against Appellant.

The consequences of such tax are important, first, as to the very substantial tax heretofore paid by Appellant, and not deducted from dividends, and directly involved on this appeal; and, second, any future taxes, which the Wisconsin

Supreme Court now holds may not be absorbed by the corporation, but must be withheld from each dividend. Such withholding would necessarily involve heavy expense and loss of good will of stockholders. The tax on a quarterly dividend of $.625 per share on common stock in 1937 on even twenty shares would have been only $.01825 (2½% tax on 5.8% of dividend of $12.50) (Rec. 147). There were 32,000 stockholders. This calculation would have to be made four times a year (for each quarterly dividend) for each stockholder. Loss of good will of stockholders, residents of other states from Maine to California and of foreign countries, critically demanding explanation as to why their dividends had been nicked for Wisconsin taxes, would be incalculable.

The first two issues in this case, (1) as to the validity of the Dividend Tax Act as against foreign corporations and their nonresident stockholders, exercising the privilege of "declaring and receiving dividends" outside of Wisconsin, and (2) the validity of the law as applied to dividends from income accumulated prior to enactment of the law, grow out of the divergent views of the Wisconsin Supreme Court and of this Court as to the nature of the tax and the incidence thereof.

(a). *The issue involving validity of the Privilege Dividend Tax Act as to foreign corporations and their non-resident stockholders.*

The decision of this Court in Wisconsin v. *J. C. Penney Co.*, 311 U. S., 435; 85 L. Ed., 267, *is not controlling here.* Since the decision of this Court in the *Penney* case there have been vitally important determinations with respect to the Wisconsin Privilege Dividend Tax which make the issues presented on this appeal radically different from those presented to this Court in the *Penney* case. Since

this Court's decision in the *Penney* case, the Wisconsin Supreme Court has held explicitly:

1. That the Privilege Dividend Tax can in *no sense* be considered an additional *tax on corporate income.*

2. That the tax is on the *stockholder* and must be withheld from *his dividend.*

3. That the tax cannot be deducted as a business expense by the corporation.

4. That the tax cannot be considered as an income tax on *non-resident stockholders,* and as such would be invalid under the Wisconsin Constitution.

5. That the formula to be used for ascertaining the tax where, as here, the dividend was paid from surplus, must be entirely different from that considered by this Court in the *Penney* case. (The formula considered by this Court in that case was the Wisconsin statutory income tax formula. To meet objections to the statutory income tax formula, the Wisconsin Department of Taxation devised the formula actually applied in determining Appellant's tax.)

All agree that mere labels are not "instruments of adjudication." This Court has stated: "for constitutional purposes the decisive issue turns on the operating incidence of the challenged tax". (*Wisconsin* v. *J. C. Penney Company,* 311 U. S. 435, 444, 85 L. Ed. 267, 270).

Consequently the real nature of the tax, regardless of labels, and the operating incidence of that tax, are fundamental in this case. We look, therefore, to the latest exposition by the Wisconsin Supreme Court.

The Wisconsin Supreme Court, in the instant case, recognizing that "This case is another chapter in the long history of litigation concerning the dividend tax law", noted that in an early chapter, i. e., in *J. C. Penney Company* v. *Tax Commission,* 233 Wis., 286; 289 N. W., 667, it had held that

as applied to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin,

> "the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax" (P. 203).

For that holding the Wisconsin court had relied principally on the case of *Connecticut General Insurance Company* v. *Johnson*, 303 U. S. 77, where, as the Wisconsin court now says, "upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax."

The Wisconsin Supreme Court (in the instant case) went on to note the next chapter in the litigation, the appeal to this Court, where as the Wisconsin court said:

> "Judgment in the *Penney* case was reversed by a divided court. It was held [by the United States Supreme Court] that the practical operation of the legislation is to impose an additional tax upon corporate earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends" (P. 203).

The Wisconsin court recognized that this Court in the *Penney* case had taken notice of the Wisconsin court's determination that the tax was "upon a transaction wholly beyond Wisconsin's borders or reach", but had stated the inquiry to be whether Wisconsin had "transgressed its taxing power because its Supreme Court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax upon the privilege of declaring dividends rather than a supplementary income tax." This inquiry, it was stated by the

Wisconsin court, was resolved by this Court's determination that:

> "For constitutional purposes the decisive issue turns upon the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society" (P. 204).

The next chapter in the litigation, noted by the Wisconsin Supreme Court, was upon the remand of the *Penney* case when, in the language of the Wisconsin court in the instant case, that court, *"(1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called, and (4) made certain directions as to its computation."* (See Appendix C hereof, pages 64, 69) (243 Wis. 198, 205).

Between these divergent views as to the nature of the Wisconsin privilege dividend tax, that is, the United States Supreme Court's view that this was an income tax (notwithstanding the Wisconsin court had declared it was in no sense an income tax against the corporation and that considered as an income tax against non-resident stockholders it would be invalid under the Wisconsin Constitution) and the view of the Wisconsin Supreme Court that this was a privilege tax (which, being upon a privilege wholly exercised outside the state, would be unconstitutional under the Federal Constitution), the Wisconsin Supreme Court, unlike the trial court, saw no dilemma. (Cf. opinion of trial court, Appendix B hereof, page 54.) The Wisconsin Supreme Court assumed to resolve the supposed dilemma by

declaring that this Court had established "as the jurisdictional fact" upon which the Wisconsin jurisdiction to levy the tax is predicated, "that the corporation paid the dividends in whole or in part out of property located in this state, or business transacted here. • • • That the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from this activity are traceable to the fund from which dividends are paid." In this aspect the Wisconsin court put aside the privilege feature of the law, saying "so far as the constitutional aspects of the cases are concerned, the Supreme Court has reduced the privilege feature of the tax to mere conditions or contingencies upon the happening of which the tax accrues."

While perceiving no conflict, "so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders and hence beyond her jurisdiction", the Wisconsin court resolutely reiterated its position thus:

> "We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. • • • The constitutional question considered material and decided by this court in the original *Penney* case involved the Federal Constitution and has been answered by the Supreme Court."

Decided by the Wisconsin Supreme Court on the same day as this case were the companion cases, *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation*, 243 Wis., 216, 10 N. W. 2d, 140, and *Blied* v. *Wisconsin De-*

partment of Taxation, 243 Wis., 221, 10 N. W. 2d, 142, involving, from quite different aspects, the precise question as to whether the Wisconsin privilege dividend tax was upon the corporation, or upon the stockholders. In the case first mentioned, which was held to control the second case, the Wisconsin Supreme Court said:

> "The real question in this case is: on whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the Supreme Court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend. * * * That power (of this state to impose this very tax) having been sustained, *regardless of what the tax be called or where its burdens may be considered to fall*, it is immaterial that the Supreme Court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the

dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case. It follows that appellants' contentions must fail." (Emphasis ours.)

For fuller expression of that determination so steadfastly adhered to, "that this is a *privilege tax*", *against the stockholder*, in contrast to a "supplemental *income tax*" *against the corporation*, we quote from the Wisconsin court's unanimous opinion on remand of the *Penney* case:

"As we understand the law our construction of the state statute is conclusive upon the supreme court of the United States. • • • If there has been a shifting of labels in this case, it was not done by this court. It is perfectly true that the tax cannot be sustained as an income tax under the law of this state. Under our constitutional amendment authorizing the levying of an income tax, sec. 1, art. VIII, Const., it has been consistently held that an income tax is a burden laid upon the recipient of an income and the amount of the tax is measured by the amount of the income. • • • Under its laws this state cannot and it does not undertake to tax the income of citizens of other states who are not doing business in this state. Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not a tax on the privilege of declaring and receiving a dividend *as we hold it to be*, then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof. *In no sense and to no extent whatever is it a tax upon the income of the corporation.*" (Emphasis ours.) (238 Wis., 72-73, 298 N. W., 188)

(b) *The issue as to validity of the Dividend Tax Act as applied to dividends from income accumulated prior to enactment of the law.*

The second issue, not heretofore presented or passed upon by this Court, is whether, if valid at all, the Wisconsin Privilege Dividend Tax Act, within the principles of due process under the Federal Constitution, may be sustained to impose a tax upon dividends declared and paid after the enactment of the law, but from income derived and accumulated by the corporation over an indefinitely long period prior to the enactment of the law. Here again the fundamental issue depends upon a determination as to the nature of the tax, whether grounded upon "the substantial privilege of carrying on business in Wisconsin" granted by the State to the corporation, or whether based solely upon the privilege of declaring and receiving dividends.

The Wisconsin Supreme Court in the instant case held that it was apparent the legislature meant to levy the tax on dividends paid out of net corporate earnings "without regard to the year or years during which the earnings accrued", but the court was evenly divided on the issue as to the validity of the law in that respect, three Justices being of the opinion "that since this is a privilege tax on transactions by which dividends are paid subsequent to the enactment of the statute, the tax is prospective and not retroactive in operation when it [the tax] is imposed on only such of those transactions as occurred in the year in which it is imposed", and three Justices being of the view:

> "(1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation, or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for

the tax, is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent' transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion." (P. 208)

One Justice, Mr. Justice Barlow (who had been Tax Commissioner at the time of the assessments in question) did not participate in the decision of the case. Because the Justices participating in the decision on this issue were equally divided, the judgment of the lower court and the assessment of the tax were affirmed.

The "analogy to the income tax cases" adopted to sustain the views last quoted in favor of a "permissible retroactivity" to "recent transactions" is found in *Welch* v. *Henry*, 223 Wis. 319, 271 N. W. 68. On appeal to this Court that case was affirmed (*Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87), but as will be shown under a subsequent heading of this Statement, limitations there expressed by this Court upon the permissible retroactivity of tax legislation, as compared even with the view of those three Justices of the Wisconsin court who would have denied the retroactive operation of the law only to dividends from "earnings in Wisconsin accrued prior to the last corporate fiscal year preceding enactment" of the law, present a substantial federal question. Even more substantial is

the federal question presented by the affirmance (by the evenly divided court) of the assessments upon dividends without any regard to length of the period prior to enactment of the law during which the earnings had accrued.

Upon the question as to the permissible retroactivity of such a tax law, if valid at all, one of the factors considered by this Court is the novelty of the tax. It is at once apparent that there had never been a precedent for the Wisconsin Privilege Dividend Tax. Whether regarded as grounded upon the privilege granted to the corporation to do business in the state or upon the privilege of declaring and receiving dividends, there never had been in Wisconsin, or any other state so far as we know, any such tax upon non-resident stockholders of a foreign corporation authorized to transact business in the state. Such a tax could not reasonably have been anticipated at any time before the legislative process actually began. Thus even the analogy of the income tax cases, where permissible retroactivity has been extended to the tax year preceding the enactment, would not justify retroactivity here to cover even the last fiscal year preceding the date of the enactment, that is, the distribution of income earned by Appellant on and after January 1, 1934 (the law having taken effect on September 26, 1935).

(c) *The issue involved in the adoption of a formula for determining the basis of the Privilege Dividend Tax not specified by the Act.*

The third issue, also not heretofore presented to or passed upon by this Court, is whether the assessments made by the Wisconsin Department of Taxation, on a formula not provided for by the statute, are a denial of due process of law under the Fourteenth Amendment of the Federal Constitution.

We have explained above (p. 7) the method adopted by the Wisconsin Department of Taxation after the Supreme Court of Wisconsin on remand of the *Penney* case from this Court held that the income tax fraction prescribed by the statute could not be applied when the dividend was paid not out of current earnings but out of surplus. The formula adopted by the Department is vitally different from the statutory formula. To find the portion of the year's income derived from Wisconsin it applies the income tax fraction each year not to taxable income as is done under the income tax chapter, but to *book income*, a very different figure. When a dividend is paid it taxes, as having been derived from Wisconsin, that proportion of the dividend which the amount of the accumulated *book* earnings from Wisconsin (so-called Wisconsin earnings reflected in surplus) bears to the entire *book* surplus. This notwithstanding the Wisconsin Privilege Dividend Tax Law provides that the portion of the dividend derived from Wisconsin shall be determined in accordance with the provisions of Chapter 71, the Income Tax Chapter.

Chapter 71 provides that unless a separate allocation is made, the amount of the dividend derived from Wisconsin shall be allocated on the basis of the income tax formula explained above. It provides no alternative formula.

The third question presented on this appeal arises from the use of this formula devised by the Wisconsin Department of Taxation and not provided for in the Income Tax Chapter nor in the Privilege Dividend Tax Law. It raises the question whether the use of an unauthorized formula does not deny Appellant due process of law under the Fourteenth Amendment of the Federal Constitution.

The Federal Questions Involved Are Substantial.

(a) *The substantial question remaining in respect to validity of the Privilege Dividend Tax Act as against foreign corporations and their non-resident stockholders.*

The substantial importance of the federal questions here involved is at once apparent upon considering the diverse decisions of the lower federal courts, depending on whether they adhered to the construction of the Privilege Dividend Tax Act announced by the majority of this Court in the *Penney* case or whether they accepted the construction placed upon the law by the Wisconsin Supreme Court.

Thus the Federal District Court for the Eastern District of Wisconsin, in *Wisconsin Gas & Electric Co.* v. *U. S.*, 46 Fed. Supp. 929 (1942), considered whether, for federal income tax purposes, the corporation was entitled to take deduction of the Wisconsin privilege dividend tax. That court compared the majority and the minority opinions in the *Penney* case, and said:

> "We would be strongly inclined to agree with the opinion expressed by the minority, but are bound to follow the conclusion of the majority opinion, which states at page 442 of 311 U. S. at page 248 of 61 S. Ct.; '* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.'
>
> These words of the majority opinion cannot be lightly brushed aside. On this point there was a direct and emphatic conflict with the viewpoint of the minority. If the Wisconsin privilege dividend tax 'is to impose an additional tax on corporate earnings', and if 'by the Privilege Dividend Tax of 1935 Wisconsin super-

imposed upon this income tax a tax on corporate income that is paid out', then there can be little doubt but that the majority of the Supreme Court held the tax to be on the corporation and not upon the shareholders. It is apparent that the validity of the tax was upheld on that basis.". P. 930.

This case was appealed by the Government to the Circuit Court of Appeals, Seventh Circuit, but pending such appeal the Wisconsin Supreme Court rendered its decision in the instant case and the companion cases of *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation* and *Blied* v. *Wisconsin Foundry & Machine Company.* (For opinions see Appendix D and E hereof.) In view of those decisions of the Wisconsin court, the Circuit Court of Appeals reversed the District Court and held that the corporation was not entitled, in determining its federal income tax, to deduct the Wisconsin privilege dividend tax. (*Wisconsin Gas & Electric Co.* v. *U. S.*, 138 Fed. 2d — (Nov. 8; 1943.)) The Circuit Court of Appeals considered that the issue "depends upon whose burden it is to pay this tax," found that subsequent to this Court's decision in the *Penney* case, the Supreme Court of Wisconsin had answered the question as to where this burden rests, and quoted the Wisconsin court's conclusion:

> "We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the Penney case."

The Circuit Court of Appeals thereupon concluded:

> "Thus, it will be seen that the Supreme Court of Wisconsin has decided very clearly that *the burden of*

this tax is upon the stockholder and not upon the corporation, and that it was not an expense of the corporation." (Emphasis ours)

The Circuit Court of Appeals recognized that at the time the District Court decided the case the Wisconsin Supreme Court had not decided *Wisconsin Gas & Electric Co.* v. *Wisconsin Department of Taxation*, or *Blied* v. *Wisconsin Foundry and Machine Co.*, supra, but had relied on *Wisconsin* v. *J. C. Penney Co.*, 311 U. S., 435; and of this the court said:

> "The reasoning of that case would seem to sustain the District Court's position."

Further illustration of the contrary result consequent upon following the view expressed by the majority of this court in the *Penney* case, is found in the decision of the Tax Court of the United States in *Montreal Mining Company* v. *Commissioner*, decided September 16, 1943, hence subsequent to the Wisconsin court's decision above noted, but prior to the decision in the *Wisconsin Gas & Electric Company* case. As in the *Wisconsin Gas & Electric Company* case there was involved the deductibility of the Wisconsin privilege dividend tax. The Commissioner contended that the privilege dividend tax is a levy upon the stockholders and consequently should be disregarded entirely in the taxation of the corporation's income. On this issue the Tax Court said:

> "The Supreme Court, in *Wisconsin v. J. C. Penney Co.*, 311 U. S., 435, considered the Wisconsin privilege dividend tax in connection with a constitutional question. In discussing the statute imposing such tax the Court said:
>
> * * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this

> tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.
>
> Thus, it is apparent that the tax in question was there determined to be a levy on corporate income. Upon the authority of that decision, we hold in petitioner's favor on this issue. The tax is deductible under section 23 (c) of the Revenue Acts of 1934 and 1936."

In the light of the now explicit and authoritative construction of the Wisconsin Privilege Dividend Tax Act by the Wisconsin Supreme Court, that it is a privilege tax imposed against the stockholders, application of the principles laid down by this court in *Connecticut General Ins. Co.* v. *Johnson*, 303 U. S. 77, 82 L. Ed. 673, and never retracted, not only presents a most substantial federal question, but compels the striking down of the Wisconsin privilege dividend tax law insofar as it is an attempt by Wisconsin to tax transactions of citizens of other sovereign states living outside her boundaries and regulated by the law of the state of domicile or residence. In that case a Connecticut Life Insurance Company did business in California under license from that state. It entered into contracts with other insurance companies, also licensed to do business in California, reinsuring them against loss on policies written by them in California on the lives of California residents. The contracts were made in Connecticut, premiums were paid there, and the losses were there payable. California imposed a tax upon the privilege of the company to do business within California, measuring the tax by the gross premiums received. California officials attempted to collect the tax on premiums received by the Connecticut corporation under the reinsurance contracts in question, and

the Supreme Court of California sustained the tax. In the *Penney* case the majority, distinguishing the *Connecticut General Life Insurance Company* case, said that in the precise circumstances presented by the record in that case "it was found that the tax neither in its measure nor in its incidence was related to the California transactions."

Now the authoritative construction of the Wisconsin law by the Wisconsin court establishes that, *as applied to foreign corporations, and their non-resident stockholders, the Wisconsin tax, both in its incidence and in its measure, is related to transactions outside of Wisconsin.* It is a tax against the non-resident stockholder measured by and subtracted from his right to receive payment of dividends declared and paid outside of Wisconsin and under the sanction of laws of sister states. The principle of the *Connecticut General Insurance Co.* case is, therefore, directly applicable.

In *Provident Savings Life Assurance Society* v. *Kentucky*, 239 U. S. 103, this Court considered a Kentucky privilege tax on a life insurance company which previously had carried on a life insurance business in the state, still continued its contracts on the lives of Kentucky residents, but had withdrawn from Kentucky and thereafter collected premiums on its Kentucky contracts at its home office in New York. In holding that Kentucky could not lay a privilege tax against the Company this Court said:

> "Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (*Louisville & J. F. Co.* v. *Kentucky*, 188 U. S. 385; *Delaware L. & W. R. Co.* v. *Penn.*, 198 U. S. 341; *Union Ref. Transit Co.* v. *Kentucky*, 199 U. S., 194); and the principle involved applies to the assertion of authority on the part of the state to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control." (P. 112)

And continuing, at pages 113 and 114:

> "As a privilege tax the tax rests upon the assumption that what is done depends upon the state's consent. But the continuance of the contracts of insurance already written by the company was not dependent on the consent of the state. * * * Neither the continuance of the obligation itself nor acts done elsewhere on account of it can be regarded within the state's control."

We have accepted as well established the principle that the construction which the Wisconsin court has placed upon the Wisconsin Act in respect to the nature of the tax and its incidence is final and binding on the United States Supreme Court. That principle was asserted by the Wisconsin Supreme Court in *J. C. Penney Co.* v. *Tax Commission*, 238 Wis. 69, 72, 298 N. W. 186, 188. That view was accepted by the Circuit Court of Appeals in *Wisconsin Gas & Electric Co.* v. *United States*, 138 Fed. 2d (Nov. 8, 1943). It, therefore, should be observed that insofar as this Court, in the *Penney* case, construed the Wisconsin law as imposing a supplemental income tax upon the corporation, as distinguished from a privilege tax against the stockholder, as it had been previously characterized in that case by the Wisconsin Supreme Court, this Court assumed a prerogative which is inconsistent with our constitutional system of government. No doubt the United States Supreme Court may examine for itself, and place its own construction on a state law, and in so doing may overrule the construction placed upon the law by the state court, in order to *strike down* the state statutes *as an encroachment* upon rights guaranteed by the Federal Constitution. This authority of the United States Supreme Court to correct judgments of state courts necessarily is inherent in the duty of the United States Supreme Court to prevent encroachment upon the Federal Constitution or the invasion of rights guaranteed by the

Federal Constitution. It is not, however, a function of the United States Supreme Court to review the judgments of state courts for the correction of errors *generally*. Until this Court's decision in the *Penney* case there was, so far as we are aware, no precedent in which the United States Supreme Court had overruled the highest court of a state in respect to the construction of a state law for the purpose or with the result of *sustaining* the state law. The distinction is vital.

In *Phoenix Insurance Co.* v. *Gardiner*, 78 U. S., 204, 206; 20 L. Ed., 112, the Court said:

> "* * * Now, we have repeatedly held that the construction of state statutes belongs to the state courts, and is not a Federal question which we can revise in a writ of error to a state court. It is true, if the state court gives such a construction to a state statute as to make it conflict with the Constitution or laws of the United States, and sustains its validity after giving it such construction, and thereby deprives a party of his rights under the said Constitution or laws, then a Federal question is raised, and we can review the decision on the point of the validity of the statute. * * *."

In *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64, 79; 82 L. Ed. 1188, 1194, the Court quoted with approval:

> "'* * * Supervision over either the legislative or the judicial section of the States is in no case permissible except as to matters by the Constitution specially authorized or delegated to the United States. Any interference with either, except as thus permitted, is an invasion of the authority of the State and, to that extent, a denial of its independence.'"

In *Rawlins* v. *Georgia*, 201 U. S., 638, 639; 50 L. Ed. 899, 900, it was said:

> "If the State Constitution and laws as construed by the state court are consistent with the Fourteenth Amendment we can go no further."

True, the opinion of this Court in the *Penney* case declared that "ascertainment of the scope of the exaction—what is included in it—is for the state court." However, this statement of principle appears not to have been honored by the Court in holding, contrary to the Wisconsin court's declaration, that this was a supplemental income tax on the corporation and as such was within the power of the state to impose. It may be said in explanation of this seeming failure of this Court to give full credit to the State court's construction of the law, that the Wisconsin Supreme Court had not at that time, as it has since in the instant case, fully and explicitly declared that the incidence of the tax is upon the stockholder. Until the questions as to the practical operation of the law were presented in this and the companion cases which were considered and decided at the same time, the Wisconsin court had not been required to pass upon the incidence of the tax.

Whatever may be the true principle to be deduced from the majority opinion of this Court in the *Penney* case, it is evident from the minority opinion in that case that the four dissenting members of this Court considered that in determining the nature and incidence of the tax in question the majority had disregarded the construction placed upon the law by the state court. It is evident too that on remand of the *Penney* case the Wisconsin Supreme Court, though compelled on the whole to accept the determination of this Court as to the state's power to tax, considered that this Court had refused to accept the Wisconsin court's determination as to the nature of the law and the incidence thereof. The District Court for the Eastern District of Wisconsin, in *Wisconsin Gas & Electric Co.* v. *United States*, *supra*, confronted by the "direct and emphatic conflict" between the majority opinion and the minority opinion of this Court in respect to the *nature* and the *incidence* of the tax, was constrained to accept the majority opinion,

but on appeal in that case the Circuit Court of Appeals has accepted as the authoritative determination of these two pivotal considerations the most recent determination of the Wisconsin Supreme Court in the instant case. Upon the foregoing, we submit that the decision of this Court in the *Penney* case has given rise to contrary views in respect to vital jurisdictional concepts as to the nature of the tax and the incidence thereof, and has created most substantial federal questions.

(b) *Substantial federal questions are involved in the retroactive operation of the Act on income accumulated prior to date of its enactment.*

Upon the assumption that the Privilege Dividend Tax Act has any validity at all as applied to Appellant, a foreign corporation, and its non-resident stockholders, there arises a further question as to the retroactive operation of the act against the challenge that such operation violates due process under the Fourteenth Amendment of the Federal Constitution. On this question it is not enough to look at the simple transaction of declaring and receiving dividends; it is necessary to look to whatever foundation has been shoved under the tax structure to support its constitutionality, however unstable and anomalous that may be. The only ground that has been suggested to sustain the tax is the privilege granted by the State to the corporation to transact business and derive income in the state; that, it has been said, is the privilege to which the tax bears the requisite fiscal relationship. (*Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267.) In the instant case the Wisconsin court said:

> "We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint

of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend." 243 Wis. 198, 206 10 N. W. 2d 169, 172.

Thus compelled to accept the determination of this Court, the Wisconsin court, in the instant case, pointed out that this Court by its decision had reduced the privilege of declaring and receiving dividends "to mere conditions or contingencies, on the happening of which the tax accrues." Clearly in considering the retroactive effect of the tax, the "jurisdictional fact" or "basis of Wisconsin's power to tax" is of greater importance than the "mere conditions or contingencies upon which the tax may accrue." Especially is this true when those "mere conditions or contingencies", namely, the declaration and receipt of the dividends, occur entirely outside the state.

If the State's power to tax the non-resident stockholders of a foreign corporation is to be justified by the privilege granted by the State to that corporation to derive income from the state, then under the decisions of this Court as to the permissible retroactivity of new tax laws the thrust of that tax cannot reach income earned by the corporation before the date of the enactment of the law. In *Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87, this Court affirmed the Wisconsin court in sustaining application of the Wisconsin income tax retroactively to "recent transactions", i. e., dividends received in a prior year. Against the objection that the tax because retroactive was a denial of due process, this court, at page 147, said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. * * * Since,

in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process."

In the instant case, on the question as to the validity of the law as applied to dividends from surplus accumulated prior to enactment of the law, the Wisconsin Supreme Court was evenly divided, one group being of the opinion that the law could not be applied to the distribution of earnings of the corporation "accrued prior to the last corporate fiscal year preceding enactment of the Wisconsin privilege dividend tax." By the tests laid down by this Court, even the retroactivity which would have been permitted by the members of the Wisconsin court just mentioned would be condemned as arbitrary and lacking due process. For the Wisconsin privilege dividend tax there was no precedent in Wisconsin law, nor, so far as we are aware, in the laws of any other state. At no time prior to the initiation of the particular legislative process could that tax have been anticipated. During the years prior to 1935, while Appellant was exercising the privilege of doing business in Wisconsin and accumulating the surplus from which the dividends in question were later paid, there was no intimation of a tax to be imposed *generally* upon residents and non-residents alike upon the *distribution* of its Wisconsin income. Indeed, there was overwhelming precedent in the decisions of the Wisconsin Supreme Court that such a tax could not constitutionally be imposed. (*Newport Co.* v. *Tax Comm.*, 219 Wis. 293; *State ex rel. Manitowoc Gas Co.* v. *Tax Comm.*, 161 Wis. 111; *Stone* v. *Tax Comm.*, 197 Wis. 71.

In the dissenting opinion in the *Penney* case, rendered by Mr. Justice Roberts, Mr. Chief Justice Hughes, Mr. Jus-

tice McReynolds and Mr. Justice Reed concurring, it was said:

> "I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders". P. 446.

For the privilege of doing business, granted by Wisconsin to Appellant for the years prior to the enactment of the privilege dividend tax, Wisconsin had exacted certain conditions in the way of franchise fees and income taxes. Those conditions Appellant had fully met. The privilege so granted to Appellant had ripened into vested rights, the income derived from Wisconsin business, completely discharged from all income taxes or other charges or restrictions, had been reduced to capital, had been sent outside of Wisconsin, and had become an indistinguishable part of Appellant's funds held beyond the borders of Wisconsin. There, under principles announced by this Court, Appellant's funds were "protected from legislative encroachments by constitutional guaranties." (See *Coolidge* v. *Long*, 282 U. S., 582, 603; 75 L. Ed., 562, 570.)

(c) *Substantial federal question involved in use of formula for determining basis of tax not prescribed by the Act.*

Finally, we submit that the very use of the formula adopted by the Wisconsin Department of Taxation in arriving at the basis for Appellant's tax raises a substantial federal question.

In the first place, it brings in question the very designation of the tax as an additional tax on corporate income. Mr. Justice Frankfurter, in the majority opinion in the

Penney case, used as an argument for the conclusion that the Wisconsin privilege dividend tax is in the nature of an additional tax on corporate income, that the amount of the dividend derived from Wisconsin was found by the income tax fraction. But the amount of the dividend derived from Wisconsin, in Appellant's case, is not found by the Income Tax fraction, but by an entirely different fraction, not provided for in the Wisconsin privilege dividend tax nor in the Income Tax Chapter. The Income Tax fraction is used only to obtain the portion of the *book* income of each year derived from Wisconsin, and then the Income tax formula is discarded. When a dividend is paid the amount derived from Wisconsin is allocated on a fraction found by dividing so-called Wisconsin earnings reflected in surplus by total surplus.

Yet the Wisconsin Privilege Dividend Tax Law is mandatory in its requirement that the amount of the dividend attributable to Wisconsin shall be found under the terms of Chapter 71. Under Chapter 71, there is no alternative formula provided. If the Department of Taxation cannot make a separate allocation, it must use the Income Tax fraction and no other. It has not made a separate allocation, and it has used a fraction entirely different from the Income Tax fraction, unknown to the Wisconsin Privilege Dividend Tax Act.

We submit that it is an important federal question whether a tax resulting from the application of a formula unauthorized by the Wisconsin Privilege Dividend Tax Act and unauthorized by the Wisconsin Income Tax denies the taxpayer due process of law under the Fourteenth Amendment. In the case of *Davis* v. *Wallace*, 257 U. S., 478, the United States Supreme Court held that where the formula provided by the statute could not constitutionally be applied, the taxing officers were not "at liberty to assess it on another and different basis which the statute shows

was not to be applied to corporations of the class to which these Railroad Companys belong." It added "Of course we cannot so hold." Likewise in *Oklahoma* v. *Wells Fargo & Co.*, 223 U. S., 298, Mr. Justice Holmes, writing the opinion, said that "Neither the court below nor this court can reshape the statute simply because it embraces elements that it might have reached if it had been drawn with a different measure and intent" P. 302.

The very essence of due process, particularly in the case of a tax, is governmental action under a method authorized by law. The formula devised by the Wisconsin Department of Taxation in this case is wholly unauthorized by the statute.

This Court has held that a formula resulting in allocating an excessive amount of income or of property to the taxing state denies due process of law. It would seem a fortiori that an allocation on an unauthorized formula denies due process.

We therefore submit that there is a substantial federal question whether an assessment under this formula is not a denial of due process of law under the Fourteenth Amendment.

The Manner in Which the Federal Questions Were Raised.

Judge Alvin C. Reis, of the Circuit Court for Dane County, in his written opinion in the instant case (Appendix B hereof), responding to briefs and arguments on behalf of Appellant, said:

> "The International Harvester Company is not asking us to hold simply that the statute does not apply to it. In substance, it is re-opening and submits that we are entitled to re-open the entire mooted question of the *constitutionality* of the privilege dividend tax law as affecting foreign corporations."

After referring to the conflicting decisions of this Court and of the Wisconsin Supreme Court in the *Penney* case, Judge Reis, in his opinion, made this comment:

> "We agree with counsel for the International Harvester Company that an immaculate dilemma has been created."

Upon further analysis of the conflicting decisions in the *Penney* case Judge Reis concluded:

> "Here then is the deadlock: If the tax is a transaction tax, as Wisconsin's court says it is, then it is void under the *federal* constitution; and the federal court should so hold it. If on the other hand it is an income tax, it can be an income tax only on individuals, according to the Wisconsin court, and then it becomes void under the *state* constitution; and the *state* court should so hold it."

Appellant, in its brief before the Wisconsin Supreme Court, presented with appropriate argument the following proposition:

> "II.
>
> "Taxation without jurisdiction is a denial of due process, and a privilege or excise tax cannot be levied for the privilege of doing acts which are actually done outside the jurisdiction. Such due process is guaranteed by the Fourteenth Amendment of the Federal Constitution, as well as by the Wisconsin Constitution. The Privilege Dividend Tax Law as here applied, and the taxes assessed thereunder and sustained below, violate such due process and the rights of appellant and of its stockholders under the Federal Constitution."

Appellant also presented in its brief by appropriate arguments the following propositions:

> "III.
>
> The presumption adopted in the assessment in question, namely, that the International Harvester Com-

pany paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business reflected in surplus, bore to its total surplus, is wholly unauthorized by the statute."

"IV.

Where a statute provides a method of allocation and does not clearly grant to the Tax Commission authority to supply a formula in case the statutory formula proves unworkable or unconstitutional in the case of the particular taxpayer involved, the Tax Commission has no authority to supply a formula of its own. The Wisconsin Department of Taxation, therefore, has no authority to apply the formula based on surplus derived from Wisconsin."

Appellant further presented in its brief and presented with appropriate arguments the following proposition:

"V.

The State of Wisconsin cannot tax any dividend which was derived from earnings accumulated prior to September 26, 1935, when the Wisconsin Privilege Dividend Tax took effect."

The Wisconsin Supreme Court, in its decision in the instant case (Appendix A hereto), said at pages 201 and 206:

"It is contended that the privilege dividend tax contravenes the due process provision of the Wisconsin constitution and of the federal constitution; that the computation adopted by the Wisconsin Department of Taxation is not authorized by the Wisconsin dividend privilege tax law, but on the contrary, that the dividend tax law prescribes a wholly different formula; that this was not followed by the Tax Department; that Wisconsin may not tax the privilege of declaring and receiving dividends derived from earnings accumu-

lated prior to the date when the Wisconsin dividend tax took effect.

"The constitutional question considered material and decided by this Court in the original *Penney* case involved the Federal Constitution and has been answered by the Supreme Court. We consider the matter closed."

Appellant, within the time allowed, filed its motion for rehearing before the Wisconsin Supreme Court, and in its brief in support of such motion urged upon that court the following:

"If this court remains irreconcilably divided on the question whether the privilege dividend tax law is fatally retroactive, it should in any event state whether the determination of that issue involves the Wisconsin Constitution, the Federal Constitution, or both."

Appellant, in such brief in support of its motion for rehearing before the Wisconsin Supreme Court also made the following proposition with appropriate argument:

"B. The privilege dividend tax, even if otherwise valid, insofar as it operates to impose taxes on the distribution of earnings accumulated prior to date of enactment is retroactive and violative of the due process provisions of Sections 1 and 9 of Article 1 of the Wisconsin Constitution and the Fourteenth Amendment of the Constitution of the United States."

Appellant, in the same brief urged the following:

"The formula adopted by the Wisconsin Department of Taxation is a denial of due process of law."

Appellant concluded its brief on motion for rehearing with the following proposition and argument:

"The privilege dividend tax on the whole violates the due process provisions of the Wisconsin Constitution

and the Fourteenth Amendment of the Federal Constitution."

The Wisconsin Supreme Court, in its opinion denying motion for rehearing (Appendix B hereof), said:

> "In discussing the permissible retroactivity of the privilege dividend tax and noting an equal division of the court upon that point, the opinion did not indicate whether the difference in view was based upon the constitution of the State of Wisconsin, the Constitution of the United States or both. It may be useful to state that the constitutionality of the law in this respect was considered under both; and the court was of the view that the same question governed whichever constitution was applied."

It is true that in raising the question of the use of a formula not sanctioned by the statute, the Appellant did not specifically say that such use was a denial of due process under the Federal Constitution. However, it did cite two cases decided by the United States Supreme Court, *Davis* v. *Wallace, supra*, and *Oklahoma* v. *Wells Fargo & Co., supra*, each of which held that the use of an unauthorized formula was not permissible. It is true that both those cases were appeals from Federal Circuit Courts of Appeal and not from State Supreme Courts, and that the United States Supreme Court, therefore, had the whole case before it. Nevertheless, we submit that the essential ground of those decisions was manifestly that the use of an unauthorized formula is a denial of due process of law, and therefore the citation of those cases was a clear assertion by the Appellant that the Federal Due Process Clause was involved. The Trial Court and the Supreme Court of Wisconsin squarely considered the question of the use of an unauthorized formula. Moreover, Appellant did definitely raise the whole question of denial of due

process of law arising from taxation without jurisdiction and asserted that a privilege or excise tax cannot be levied for the privilege of doing acts which are actually done outside the jurisdiction. Measuring the privilege by income arising outside the jurisdiction or basing it on acts done outside the jurisdiction or measuring it by income measured by an unauthorized formula are all reasons leading to the conclusion that such a tax is taxation without jurisdiction and a denial of due process of law.

The United States Supreme Court has held that while an appellant cannot raise a new Federal question in the United States Supreme Court not raised before nor considered by the State Supreme Court, it is not confined in the United States Supreme Court to the same arguments which were advanced in the State court upon a Federal question there raised. *Dewey* v. *Des Moines*, 173 U. S., 193, 197, 198; *Keokuk & Hamilton Bridge Co.* v. *Illinois*, 175 U. S., 626, 633.

We submit that the question of the use of the unauthorized formula was definitely raised both in the trial court and the Supreme Court of Wisconsin and fully considered by those courts; that two United States Supreme Court decisions were cited which necessarily were based on Federal due process and that the whole question of denial of Federal due process by the levy of a tax without jurisdiction was raised in second Proposition quoted at page 44 above. We submit therefore that this Court has jurisdiction to consider the application of the unauthorized formula.

Cases Believed to Sustain Jurisdiction.

Appellant believes that the following cases sustain the jurisdiction of this Court:

Connecticut General Life Ins. Co. v. *Johnson*, 303 U. S., 77; 82 L. Ed., 673;

J. D. Adams Mfg. Co. v. *Storen*, 304 U. S., 307; 82 L. Ed., 1365;

Albert A. Hoeper v. *Tax Comm. of Wis.*, 284 U. S., 206; 76 L. Ed., 248;

Hans Rees' Sons Inc. v. *North Carolina*, 283 U. S., 123; 75 L. Ed., 879;

Fisher's Blend Station v. *Tax Comm.*, 297 U. S., 650; 80 L. Ed., 956.

Dated this 11th day of December, 1943.

Respectfully submitted,

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APPENDIX "A".

WISCONSIN BOARD OF TAX APPEALS.

INTERNATIONAL HARVESTER COMPANY, a New Jersey Corporation, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent.

Decision and Order, Docket No. D-5.

This is an appeal by the petitioner from an assessment of privilege dividend taxes resulting from the respondent's audit of dividend payments made by the petitioner during the period from September 26, 1935 to October 15, 1937, inclusive.

From the stipulations presented and the record before us, we make the following findings of fact: The petitioner is a corporation organized under the laws of the State of New Jersey. Its principal office is in Hoboken. During the period under review, its general offices have been located in Chicago, Illinois. The petitioner does business in every state of the United States except Nevada. Since 1920, the petitioner has had a manufacturing plant and selling branches in Wisconsin. No directors' meetings are held in this state. The meetings at which the dividends in question were declared, and all acts and proceedings with respect to the declaration and payment of such dividends, occurred at Chicago.

Dividends on its common stock are paid in quarterly installments on the 15th day of January, April, July, and October, and dividends on preferred stock are paid in March, June, September and December.

During the period here involved, the petitioner had more than 32,000 stockholders residing in every State of the United States and many foreign countries, of whom less than 2% resided in Wisconsin.

On December 2, 1937, the respondent levied an additional assessment against the petitioner in the sum of $68,838.49, exclusive of penalties and interest. Thereafter the Wis-

consin Supreme Court, on remand from the United States Supreme Court, rendered its decision in *J. C. Penney Co. v. State of Wisconsin, et al.*, 298 N. W. 186 (reversing 233 Wis. 286). Subsequent to the decision therein, the respondent recomputed the amount of privilege dividend taxes, and under date of September 22, 1941, prepared an audit report setting forth its recomputation of the petitioner's liability for additional privilege dividend taxes. This later recomputation was supplemented by one dated November 17, 1941, in which the petitioner's separate surplus was analyzed and a computation of privilege dividend taxes made with reference to such separate surplus.

The analysis of surplus and the determination of the portion of the dividends paid by the petitioner out of its surplus attributable to Wisconsin earnings, as well as the mathematical computation of the privilege dividend taxes thereon, are not here disputed.

Following the petitioner's receipt of notice of the assessment of additional privilege dividend taxes (under date of December 2, 1937), the petitioner protested the proposed assessment and requested a hearing thereon. This appeal was pending with the Tax Commission at the time that Chapter 412, Laws of 1939, was passed, and pursuant to the provisions of that Act, the within appeal was transferred to this Board.

The following question is presented for determination: Is the method of computation employed by the respondent for the purpose of computing the privilege dividend taxes due, by virtue of Section 71.60, Section 3, upon dividends declared and paid by the petitioner out of income derived from property located and business transacted in this state, valid?

The Wisconsin statutes involved are:

Section 71.60:

> "Section 3, PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to three per centum of the amount of such divi-

dends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1941. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

* * * * * * *

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state."

The respondent's computation of additional privilege dividend taxes is based upon the presumption that the petitioner paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business, reflected in its surplus, bore to its total surplus.

The petitioner predicates its contention that the privilege dividend taxes here sought to be imposed by the respondent are invalid upon its conclusion that Section 71.60, Section 3, gives no right to this State to tax dividends from prior years' income. It further maintains that said Section grants to the State the right to tax only dividends from current income which, in the absence of proof to the contrary, is presumed to be the same as the income for the year

immediately preceding and does not permit the taxation of dividends from surplus.

Our study of the Court's decision in *J. C. Penney, supra.* (May 20, 1941) convinces us that the respondent's method of computation of additional privilege dividend taxes set forth in Exhibit 7A complies with the statutory requirements (Section 71.60, Section 3), and is in conformity with the construction of that Statute as given to it by the Wisconsin Supreme Court. The applicable portion of the decision in that case declares:

> "• • • The Wisconsin earnings and earnings for particular calendar years were not segregated and had lost their identity long before the dividends here involved were paid. It is the contention of the taxpayer that the presumption created by the statute (1) is invalid and (2) has been rebutted. The taxpayers' contention requires us to consider the nature of the presumption. By its terms it operates only in the absence of evidence. Its effect is to require the taxpayer to go forward with the evidence. When evidence is introduced which rebuts it the presumption ceases to operate because it rests upon no factual basis and takes no account of the way in which the transactions of the Company are actually handled. Being a rebuttable presumption it is clearly within the power of the Legislature to create it. Evidence having been introduced which rebuts it, the controversy must be determined upon general principles of law. It is obvious from a consideration of the facts that the so-called 'trust fund' doctrine has no application to the facts in this case. The earnings of the corporation are in no sense held by it in trust for the taxing authorities of the state. The earnings are handled according to ordinary business practice. They are not earmarked or segregated or manipulated in any manner whatever. When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the

Company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus. * * *"

The argument advanced by the petitioner with respect to the respondent's authority to levy a tax upon dividends paid out of earnings derived prior to the effective date of the privilege dividend tax law is disposed of, in our judgment, by the decision in *J. C. Penney, supra.*

We find that the method of computation (set forth in Exhibit 7A), which the respondent used in determining the amount of privilege dividend taxes on dividends declared and paid by the petitioner out of income derived from business transacted and property located within the State of Wisconsin, is proper.

IT IS ORDERED:

That the additional assessment appealed from, as modified and amended by the recomputation of November 17, 1941, be and the same is hereby affirmed.

Dated at the State Capitol, Madison, Wisconsin, this 13th day of February, 1942.

WISCONSIN BOARD OF TAX APPEALS,
G. L. BROADFOOT,
Chairman;
W. J. CONWAY,
HARRY SLATER.

APPENDIX "B".

IN CIRCUIT COURT OF DANE COUNTY, STATE OF WISCONSIN.

INTERNATIONAL HARVESTER COMPANY, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent.

Before Hon. Alvin C. Reis, *Judge*.

Decision.

BY THE COURT:

This is an appeal from a decision and order of the Wisconsin Board of Tax Appeals assessing additional "privilege dividend" taxes against appellant for the period September 26, 1935 to October 15, 1937 in the sum (including interest and penalties) of approximately $70,000.00.

Appellant International Harvester Company is a corporation organized in 1918 under the laws of the State of New Jersey, with its principal office at Hoboken, N. J. The general offices are in Chicago.

This concern is admitted to do business in every state of the union except Nevada. Products of this corporation are nationally known and nationally sold, which is a fact of common knowledge.

No meetings of the directors of the corporation have ever been held in Wisconsin. These meetings always have been held in Chicago. It necessarily follows that the declaration of dividends by the corporation is an act which has occurred only in the State of Illinois and never in the State of Wisconsin.

Of the company's 32,000 stockholders, *ninety-eight per cent* are *non-residents* of Wisconsin, according to the stipulation filed herein.

Upon this basis, the first challenge in the pending lawsuit is to the applicability of Wisconsin's dividend tax law to this particular foreign corporation.

Literally, the statute itself does not apply.

Sec. 71.60 (3)(1) provides:

"*For the privilege of declaring and receiving dividends,* out of income derived from property located and business transacted in this state, there is imposed a tax . . . ." (Our italics).

"Declaring and receiving."

This corporation does not *declare* its dividends in Wisconsin nor do 98% of its stockholders *receive* dividends in Wisconsin.

Hence, it is argued, the statute does not apply.

Counsel for the appellant however do not expect this court to be so naive as to assume that the challenge is to the mere inapplicability of the statute. The situation in the *J. C. Penney* case was one of a foreign corporation, declaring dividends *outside* of the state to stockholders located *out* of the state. Yet in that litigation the Penney company finally was beaten.

State of Wisconsin *v.* J. C. Penney Company, 311 U. S. 435, 85 L. Ed. 267.

The International Harvester Company is not asking us to hold simply that the statute does not apply to it. In substance, it is re-opening and submits that we are entitled to re-open the entire mooted question of the *constitutionality* of the privilege dividend tax law as affecting foreign corporations.

The Supreme Court of Wisconsin, in a 6 to 1 decision, held it unconstitutional, Mr. Justice Fowler dissenting.

J. C. Penney Company *v.* Tax Commission, 233 Wis. 286.

The Supreme Court of the United States, in a 5 to 4 decision, held it constitutional, Mr. Chief Justice Hughes, Mr. Justice Roberts, Mr. Justice McReynolds and Mr. Justice Reed dissenting.

State of Wisconsin et al. *v.* J. C. Penney Company, 311 U. S. 435, 85 L. Ed. 267.

The majority opinion of the Wisconsin court was written by Mr. Chief Justice Marvin B. Rosenberry.

The majority opinion of the United States court was written by Mr. Justice Felix Frankfurter.

Upon remand from the court at Washington, the Supreme Court of Wisconsin again considered the nature and application and constitutionality of the tax. Mr. Chief Justice Rosenberry again wrote the opinion, which this time was unanimous.

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69.

We agree with counsel for the International Harvester Company that an immaculate dilemma has been created.

In the first *Penney* case the Supreme Court held the tax to be a transaction tax or tax on "privilege", as in terms it so states; and since the transaction happened and the privilege was exercised outside of Wisconsin, in the case of a foreign corporation such as this one, the Wisconsin court held the tax unconstitutional, being violative of due process.

When however this case reached the Supreme Court of the United States, that tribunal regarded this tax as a "supplementary income tax" upon the corporation and hence clearly within the power of the state to impose and not infringing upon the fourteenth amendment.

In the third and final round of the battle thus far, i. e., remand from the United States Supreme Court to the Wisconsin court, our local court followed the United States Supreme Court upon the issue of constitutionality *because it had to do so.* That pitches a delicate point rather abruptly but no one will question the accuracy of our assertion.

The Supreme Court of Wisconsin however, in this last decision, refused to recede from its former position that this was an excise or privilege tax. It militantly maintained that it was its right, and its alone, to say what this tax was; and that such was not the province of the Supreme Court of the United States. And thereupon and in the face of the highest federal court declaration that the tax here involved was a "supplementary income tax" upon the corporation, the Wisconsin court unequivocally de-

clared: "*In no sense and to no extent whatever, is it a tax upon the income of the corporation.*" (Our italics.)

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69 73.

We can not settle this dispute. That rests far beyond our hands.

The Wisconsin court insists that the tax is a transaction tax, which under the federal constitution makes it unconstitutional because based on out-of-state transactions. But the United States court majority opinion disregards it as a transaction tax and sets the tax up as an additional corporate income tax, the validity of which is obvious.

The Supreme Court of Wisconsin, as noted, however, will not accept it as an income tax on the corporation. Furthermore, it postulates that if it is an income tax on individuals, it is unconstitutional *under the state constitution*, because the individuals are beyond the jurisdiction of Wisconsin to tax.

"It is perfectly true that the tax cannot be sustained as an income tax under the law of this state."—Thus spoke our own Supreme Court.

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69, 72.

Therefore, as an income levy, the tax is completely *persona non grata* in this state—an unwanted black sheep in the Wisconsin court's backyard.

Here then is the deadlock: If the tax is a transaction tax, as Wisconsin's court says it is, then it is void under the *federal* constitution; and the federal court should so hold it. If on the other hand it is an income tax, it can be an income tax only on individuals, according to the Wisconsin court, and then it becomes void under the *state* constitution; and the state court should so hold it.

One living *fact* however sticks out in this mesh of speculation and expectation and of controversy: And that existing fact controls the Circuit Court for Dane County until the time, if any, when one of the higher courts changes its conclusion as to what this law is.

That salient fact is that both courts—federal supreme and state supreme—*so far* hold the law to be valid.

Whatever may be the refinements of difference as to meaning or designation of the tax, and serious as may be the clash of legal conceptions that *ultimately* may destroy it, the record thus far indicates that the tax must be accepted by lower courts as a valid tax, even as against a foreign corporation declaring its dividends out of the state to stockholders out of the state.

The Supreme Court of the United States *reversed* the decision of the Supreme Court of Wisconsin which had held the tax unconstitutional. That is the record in the federal court.

The Supreme Court of Wisconsin, upon remand, regardless of its frank and emphatic disagreement with the United States court upon the theory of the tax, concludes succinctly:

"It is held that the statute is valid; that the State of Wisconsin has jurisdiction to levy the tax * * *"

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69, 79.

The next ground for the appeal herein is the alleged unsoundness of the method employed by the Department of Taxation, sustained by the Board of Tax Appeals, in computing the tax. To adopt appellant's own construction of what respondent have done: "Basically in the computation of the tax as affirmed by the Board of Tax Appeals, the Department has attempted to analyze the surplus on the December 31st of the year preceding the year in which a particular dividend is paid, in an alleged attempt to determine the percentage of Wisconsin income in surplus at that time." (Appellant's brief, pp. 5-6.)

Sec. 71.60 (3) (4) reads:

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable

to this state shall be computed in accordance with the provisions of chapter 71. *In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend.* If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." (Our italics.)

Appellant argues that it has successfully shown that dividends were not paid out of *earnings* attributable to Wisconsin for the immediately preceding year but rather out of its general surplus. Hence, the presumption stated in the foregoing statutory clause, is said to be rebutted; and plainly it is.

The question, as we see it, then becomes: If the presumption of payment out of preceding year's earnings is rebutted, what test may or must the Department of Taxation apply?

Certainly it is not intended that there shall be a gap and that if the presumption is rebutted, there shall be no tax. Yet this in essence is the effect of appellant's argument. Incidentally, it strikes us that the legislature has proceeded with artificiality in making the basic assumption that dividends customarily are paid out of earnings of the immediately preceding year. We had thought that ordinarily they were paid out of surplus. In predicating the presumption that dividends are paid out of one year's earnings, namely those of the year most recently past, rather than out of the accumulated surplus—unless proven to the contrary—the legislators have visualized the cart before the horse; but perhaps for reasons sufficient to themselves.

Appellant's objection herein is that, the presumption being frustrated, our tax authorities went ahead and determined the portion of the dividend paid out of surplus

derived from Wisconsin (using the surplus figure as of the close of the preceding fiscal year). This, it is pointed out, is the method prescribed by 71.60 (3) (4) for a *loss;* and appellant contends that there being no loss but, on the contrary, a profit, then—under the maxim, *enumeratio unius est exclusio alterius*—the tax people have done just what the legislature inferentially said they could not do in the case of a profit.

This presents a fascinating problem, were it not for the circumstance that the Supreme Court of Wisconsin has given sanction to the formula utilized by the Department of Taxation. With that sanction before us, we can not very well pick the mechanics to pieces for theoretical reasons.

Upon remand in the *Penney* case, the Supreme Court said (J. C. Penney *v.* Tax Commission, 238 Wis. 69, 78-79):

"When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. *Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus.* The Tax Commission treated the matter as if the statutory presumption were conclusive and gave no weight or consideration to the evidence. In this the Tax Commission was in error. It is said in briefs of counsel that it would be a Herculean task to compute the amount of surplus attributable to Wisconsin income. Inasmuch as the basis upon which the Supreme Court of the United States sustained the tax is that some part of the dividend is allocable to Wisconsin income, we see no escape from the conclusion that no tax can be levied until that fact is ascertained." (Our italics.)

That the Department of Taxation in the present case has acted in pursuance of Mr. Chief Justice Rosenberry's analysis, is not and can not be disputed by appellant.

On page 11 of the brief by appellant's attorneys, they say: "There is no such thing as a Wisconsin surplus. It is therefore a gratuitous assumption, unwarranted under the statute, to declare that when the company pays a dividend, it draws on Wisconsin earnings in the proportion that Wisconsin earnings reflected in surplus bear to its total surplus."

On page 4 of the reply brief by appellant's attorneys, they say: "The only manner in which it can be said that the dividend, which was actually paid out of surplus, was partially paid out of Wisconsin earnings reflected in surplus is to adopt a new fiction in lieu of the rebutted statutory fiction."

These comments might constitute a well-deserved rebuke to the Department of Taxation, were it not for the fact that the opinion of Mr. Chief Justice Rosenberry, evidently concurred in by all the justices, points the way to what appellant calls the "unwarranted" assumption and "new fiction".

If the merits need be considered, which they need not, since the Chief Justice and the court have spoken:

Why is it not completely logical to state, as Mr. Chief Justice Rosenberry did, that when the corporation drew upon surplus containing Wisconsin income, it drew upon Wisconsin income to the extent of the proportion of that income to the whole amount of the surplus?

Moreover, as we have intimated, if this foundation is not built upon, then upon what can the Department of Taxation construct any tax whatever? And surely because a presumption is rebutted, it should not be contemplated that the bottom drops out of the tax bucket.

We repeat: Appellant's position renders the whole dividend tax nugatory. Bluntly its attorneys state (p. 7, reply brief): "Finally, there is not a word in the statute which says that a dividend paid out of surplus can be taxed. The

statute provides for taxing only dividends paid out of income."

If this is the end result of Wisconsin's dividend tax law, then that law is a dead letter, not only as to foreign corporations *but as to domestic corporations as well,* which declare dividends out of surplus. And we know that corporation do declare dividends out of surplus. A second-year law school student knows that. The law of corporations just about requires it, both as to a New Jersey corporation such as appellant and as to a Wisconsin corporation.

Section 14:8-19, Revised Statutes of New Jersey 1937, provides:

"*The directors of a corporation shall not pay dividends except from its surplus,* including surplus as determined by section 14: 8-6 of this title, or from the net profits arising from the business of the corporation. * * *" (Our italics.)

Sec. 182.19 (1), Wisconsin statutes, reads:

"No dividend shall be paid by any corporation until at least fifty per cent of the authorized capital stock has been fully paid in, *and then only out of net profits properly applicable thereto* * * *"

We grant that appellant has an academic argument to the effect that it has rebutted the presumption that dividends were paid out of the preceding year's earnings and that the statute does not call for a tax on dividends declared out of surplus, *eo nomine.*

But in that event, what was the sense in carrying the issue of *constitutionality* in the first *Penney* case to the Supreme Court of the United States? The whole matter could have been stopped in its tracks by a decision of the Wisconsin court that the statute does not tax dividends declared out of surplus.

What was the purpose of the Supreme Court of Wisconsin in the second *Penney* case in sending the case back to the Department of Taxation for a re-computation, if the law does not tax a dividend declared out of surplus? Our

Supreme Court knew that the dividend of J. C. Penney Company was declared out of *surplus*. The entire second phase of its opinion was devoted to that very proposition. (238 Wis. 69, 74-79.)

To now propound, as appellant does, that a dividend out of surplus is not taxable at all, is to accuse the legislature of futility and the Supreme Court of a glaring oversight.

Appellant's incidental criticism in this regard is that the Department of Taxation should not have used surplus *as of December 31st* of the year preceding. Appellant submits directors' resolutions which purportedly recognize something in the form of a current or daily surplus, e.g., "surplus account at April 15, 1937."

This approaches the hyper-critical. Common business sense dictates that surplus figures may be taken as of the close of the year. One cannot mark a surplus sheet like the milk man's morning card.

Finally, appellant protests of the retroactivity of the computation. That is, this surplus is an accrual from the year 1918. It can not be segregated as to time. *Ergo*, says appellant, this surplus allocation method must be erroneous to the extent that it presupposes surplus accretions *before* Wisconsin's dividend tax law ever went into effect, which was September 26, 1935. Erroneous, because, appellant argues, the taxpayer had met all of Wisconsin's requirements as to income earned prior to that date and could not constitutionally have thrust upon it an additional burden upon that income—citing the dissenting opinion of Mr. Justice Roberts in the *Penney* case.

This argument is a throw-back to the original dilemma herein described. If the tax is geared to income, then it is arguable that we are faced with a prodigiously retroactive income tax. On the other hand, if the tax is a transaction tax, then the argument mis-fires; for the *transaction* is a present one, to-wit, the immediate declaration of the dividend; and the hoary surplus is but one component in the equation by which to gauge the final quantum of the tax.

We respectfully leave that residuum of the dilemma where it belongs: To our colleagues on the Supreme Court of Wisconsin and the Supreme Court of the United States.

The Attorney General may prepare and submit to appellant's attorneys the order and judgment affirming the decision and order of the Board of Tax Appeals.

Dated August 14, 1942.

IN SUPREME COURT OF STATE OF WISCONSIN

AUGUST TERM, 1943

JANUARY, 1943 CALENDAR

No. 56

INTERNATIONAL HARVESTER COMPANY, *a New Jersey Corporation, Petitioner and Appellant*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

Wickhem, J. on re-hearing:

The court has thoroughly considered the motions for rehearing filed herein and is not disposed to modify its views or to restate or amplify its opinion in any respect but one. In discussing the permissible retroactivity of the privilege dividend tax and noting an equal division of the court upon that point, the opinion did not indicate whether the difference in view was based upon the constitution of the state of Wisconsin, the constitution of the United States of America, or both. It may be useful to state that the constitutionality of the law in this respect was considered under both; and the court was of the view that the same considerations governed whichever constitution was applied.

By the court—Motion for re-hearing is denied, with $25 costs.

APPENDIX "C"

IN SUPREME COURT OF STATE OF WISCONSIN

JANUARY TERM, 1943

No. 56

INTERNATIONAL HARVESTER COMPANY, *a New Jersey Corporation, Petitioner and Appellant*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

This is an appeal from an order and judgment of the Circuit Court for Dane County, Alvin C. Reis, Circuit Judge. Affirmed.

Appeal to the Circuit Court for Dane County from an order of the Wisconsin Board of Tax Appeals which had affirmed an additional assessment of privilege dividend taxes against appellant, International Harvester Company, a New Jersey Corporation. The order of the Wisconsin Board of Tax Appeals was dated February 13, 1942 and the order and judgment of the Circuit Court was made and entered on September 17, 1942. The material facts will be stated in the opinion.

WICKHEM, J.:

Appellant is a New Jersey corporation, having its principal office in Hoboken, New Jersey. Its general executive offices are in Chicago. So far as the record discloses, it has done business in Wisconsin since 1920. The Wisconsin dividend privilege tax law was enacted and went into effect on September 26, 1935. From December 2, 1935 to October 15, 1937 appellant paid numerous dividends totalling $39,028,188.22, but did not pay any privilege dividend tax thereon. As of the end of the year 1934, the amount of surplus accumulated from Wisconsin earnings and constituting Wisconsin surplus on the basis of the for-

mulae and method of computation prescribed by chapter 71 was $803,780.72. The amount attributable to Wisconsin as of December 31, 1935 was $2,227,449.03. The Wisconsin surplus as of October 31, 1936 was $2,608,908.26. On December 2, 1937 the Wisconsin Tax Commission, predecessor of Wisconsin Department of Taxation, notified appellant of an assessment of privilege dividend tax against it in the amount of $68,838.49, exclusive of penalties and interest, computation being based upon the statutory presumption that such dividends were paid out of previous years' earnings. Subsequently thereto, and because of the conceded rebuttal of the presumption, respondent recomputed the privilege dividend tax at $53,713.29, exclusive of penalties and interest. There is a stipulation to the effect that, assuming the law to be valid and the method of computation authorized, the amount of the privilege tax as computed is correct. The contentions made by appellant all present matters of constitutional law and statutory construction. It is contended that the privilege dividend tax contravenes the due process provision of the Wisconsin constitution and of the federal constitution; that the computation adopted by the Wisconsin Department of Taxation is not authorized by the Wisconsin dividend privilege tax law, but on the contrary, that the dividend tax law prescribes a wholly different formula; that this was not followed by the Tax Department; that Wisconsin may not tax the privilege of declaring and receiving dividends derived from earnings accumulated prior to the date when the Wisconsin dividend tax took effect.

This case is another chapter in a long history of litigation concerning the dividend tax law during which this court has passed upon the constitutionality of the law and its proper construction three times, and the United States Supreme Court has considered these matters once. *Froedtert G. & M. Co.* v. *Tax Comm.*, 221 Wis. 225, 265 N. W. 672, 267 N. W. 52; *J. C. Penney Co.* v. *Tax Comm.*, 233 Wis. 286, 289 N. W. 677; *Wisconsin* v. *Minn. Mining & Mfg. Co.*, 311 U. S. 452; *J. C. Penney Co.* v. *Wisconsin*, 238 Wis. 65, 298 N. W. 186, (upon remand).

The controversy has developed into a battle of words and labels and it may be of service to review the litigation and ascertain just what has been authoritatively determined. On September 26, 1935 the privilege dividend tax [1] went into effect and for purposes of reference so much of it as is material here is set forth in the notes. The constitutionality and construction of this law was put in issue in *Froedtert G. & M. Co.* v. *Tax Comm.*, (supra) and this court there held that it levied a tax upon the privilege of transferring from the corporation to the stock holders corporate net income derived from corporate business transacted, or property located in Wisconsin. That case involved a Wisconsin corporation, but upon rehearing, it was stated without elaborate discussion that the tax was constitutional as applied to the dividends of foreign corporations. The matter again came before this court in *J. C. Penney Co.* v. *Tax Comm.*, 233 Wis. 286, 289 N. W. 677, and it was there held that in its application to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin, the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax. This court relied principally on the case of *Connecticut Gen. Ins. Co.* v. *Johnson*, 303 U. S. 77, where upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax, and in doing so, had said:

"But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state."

Upon appeal to the United States Supreme Court, judgment in the *Penney* case was reversed by a divided Court. It was held that the practical operation of the legislation is

[1] Reporter will publish sec. 71.60, statutes of 1941, section 3 (1), (2), (3) and (4), as a foot note.

to impose an additional tax upon corporate earnings with Wisconsin, but to postpone the liability for this tax un such earnings are paid out in dividends.

"In a word, by its general income tax Wisconsin tax corporate income that is taken in; by the Privilege Di dend Tax of 1935 Wisconsin superimposed upon this i come tax a tax on corporate income that is paid out."

After noting that the act specifically levies the tax up the privilege of declaring and receiving dividends, th the taxpayer is a Delaware corporation with its princip offices and meeting place in New York, and that this cou has held the tax to be one upon a transaction wholly b yond Wisconsin's borders or reach, the Court said:

"The case thus reduces itself to the inquiry wheth Wisconsin has transgressed its taxing power because i supreme court has described the practical result of th exertion of that power by one legal formula rather than a other—has labeled it a tax on the privilege of declarin dividends rather than a supplementary income tax.

"A tax is an exaction. 'Ascertainment of the scope the exaction—what is in included in it—is for the sta court. But the descriptive pigeon-hole into which a sta court puts a tax is of no moment in determining the co stitutional significance of the exaction * * *."

"* * * For constitutional purposes the decisive issue turn on the operating incidence of a challenged tax. A state free to pursue its own fiscal policies, unembarrassed by th Constitution, if by the practical operation of a tax the sta has exerted its power in relation to opportunities which has given, to protection which it has afforded, to benefi which it has conferred by the fact of being an orderl civilized society."

"Constitutional provisions are often so glossed ov with commentary that imperceptibly we tend to constru the commentary rather than the text. We cannot, how ever, be too often reminded that the limits on the othe wise autonomous powers of the states are those in the Co stitution and not verbal weapons imported into it. 'Ta able event,' 'jurisdiction to tax,' 'business situs,' 'extra territoriality,' are all compendious ways of implying th

impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state."

Upon remand to determine such questions as were left open by the opinion of the Supreme Court, this court in *J. C. Penney Co.* v. *Tax Comm.*, 238 Wis. 69, 298 N. W. 186 (1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called, and (4) made certain directions as to its computation. The latter point need not be elaborated in this portion of the opinion. From the briefs in this case, and the memorandum of the trial court it appears to be concluded that we have here what the trial court designates an "immaculate dilemma"; that the Supreme Court of the United States has held this to be an income tax and that as such, it is invalid under the Wisconsin constitution; that the Supreme Court of Wisconsin, upon remand has persisted in designating it a privilege tax in which case the privilege being wholly exercised outside of the state, it is unconstitutional under the federal constitution.

We see no such dilemma. As we read the opinion of the United States Supreme Court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned. What the Supreme Court has done is (1) to state the factual basis upon which this law must be treated as constitutional insofar as the jurisdiction of Wisconsin to levy it is concerned and (2) to hold that given the factual basis, the law is constitutional in this aspect, regardless of the designation given it by this court. In other words, the federal Supreme Court has established the jurisdictional fact which is that the corporation paid the dividends in whole or in part out of

property located in this state, or business transacted here. If the term "jurisdictional fact" must hereafter be relegated to the limbo of outmoded terms, the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from this activity are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the Supreme Court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.

This being true, we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction. It makes no difference what this court calls the tax. It may, for other than constitutional reasons, be important to designate the tax a privilege tax, but the label has no bearing upon the controversy here. We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. Under the circumstances, we do not propose to re-examine contention heretofore made and impliedly overruled that the law is void under the Wisconsin constitution. The constitutional question considered material and decided by this court in the original *Penney* Case involved the federal constitution and has been answered by the Supreme Court. We consider the matter to be closed.

The next question has to do with the application and computation of the tax, and in connection with this a constitutional question is raised having to do with its retrospective operation and not litigated or involved in the previous litigation. From even a casual reading of the privilege dividend tax, it is clear that the legislature meant to levy it upon the paying out and receiving of dividends out of net corporate earnings in Wisconsin, without regard to the year or years during which the earnings accrued. Sub-

section 3 of section 71.60 Stats. provides without qualification that the tax shall be levied for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in this state. Subsection 3(4) provides "in the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only on dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin." (Income attributable to this state to be computed in accordance with the provisions of chapter 71.)

"* * * In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend * * *"

This merely creates a rebuttable presumption that all of the dividend was paid out of Wisconsin earnings for the year immediately preceding the payment of the dividend. It is finally provided that if the corporation had a loss for that year the commission, upon application, is to determine the portion of such dividend paid out of surplus and undivided profits derived from business transacted, and property located within the state. There is no time limit anywhere unless the reference to the presumption be tortured into some sort of limitation of the tax to dividends paid out of the previous years' earnings and this would be a disingenuous construction. The section strongly suggests that the legislature had no misgivings as to its power to reach Wisconsin earnings without regard to the time of their accrual by a tax on the privilege of paying and receiving dividends effecting their distribution.

Upon the question whether, so far as it purports to reach Wisconsin earnings without reference to the year in which they were earned, the section is unconstitutionally retroactive in application, the Court is equally divided.

Mr. Justice Fowler, Mr. Justice Fritz and Mr. Justice Fairchild are of the view (1) that since this is a privilege tax on transactions by which dividends are declared and paid subsequent to the enactment of the statute, the tax is

prospective and not retroactive in operation when it is imposed on only such of those transactions as occurred in the year in which it is imposed; (2) that the prospective character of the tax is not affected by the fact that in assessing the amount thereof,—which under the statute is to be limited to the extent that income earned in Wisconsin was used in paying the dividend in such year,—there was included undistributed income earned theretofore in Wisconsin; and (3) that these conclusions are in accord with the decision of this court upon remand in the *Penney* Case.

Mr. Chief Justice Rosenberry, Mr. Justice Martin and the writer are of the view (1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to "recent" transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion.

The court being equally divided, this results under the rules of this court in an affirmance of the judgment upon this point.

The rest of this case we consider to have been authoritatively settled by the decision of this court in the *Penney* Case upon remand. The law requires that the commission assess the tax upon the presumption that the dividend was paid out of Wisconsin earnings for the year preceding the

declaration of a dividend. Upon rebuttal of this presumption, a tax may be levied upon such portion of the dividend as is represented by Wisconsin earnings, these to be ascertained by application of the formula prescribed in Chapter 71. The proportion between the sum so arrived at and the total assets available for dividends establishes the percentage of the dividend attributable to Wisconsin earnings. In the *Penney* Case upon remand this Court said:

"• • • When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus • • •"

In making this statement it was not intended to create an artificial rebuttable presumption comparable to that created in sub-section (4) of the dividend tax act. What the court meant to hold and what we do hold is that in this situation there is a strong, if not inevitable inference to the effect noted; In other words, that the conclusion not only can be arrived at by ordinary methods of reasoning without dependence upon a judicially created presumption, but that it cannot be avoided by any evidence that we have presently in mind.

It is contended that since the statute contains no specific formula for computing the tax, this Court cannot supply one. We deem this contention unsound. If by any process reasonably calculated to accomplish the result, the amount of Wisconsin earnings involved in the declaration sought to be taxed may be ascertained the validity of the law is not impaired by the absence of detailed specifications concerning computation. The formula for ascertaining the amount of net earnings allocable to Wisconsin

is set forth in chapter 71 and the validity of this formula is well established. There is a strong if not inevitable inference that these earnings became (1) part of the general assets available for distribution as dividends, and (2) part of the dividend declared in the proportion that they bear to the total assets available for dividends. We do not deem it necessary that there shall have been a formal transfer of earnings into a surplus account. While the statutes of New Jersey, and we suppose those of nearly every state, require that dividends be paid out of surplus, the sense in which surplus is used means excess of assets over liabilities, including capital. This concern of the law as laid down by decisions and prescribed by statutes is that dividends shall not be declared out of capital. If Wisconsin earnings have gone to swell the assets of the corporation in such a way as to create an excess of assets over liabilities, and to authorize a dividend, the Wisconsin earnings are proportionately a part of this excess, whatever it be called. The formula prescribed by this court upon remand in the *Penney* Case, that is, that the Wisconsin earnings should constitute the numerator of a fraction of which the entire amount available for dividends is the denominator, is rational and workable and was applied in this case. While we recognize the force of objection that can be made to any determination reached in this matter, the foregoing conclusions are the only ones that will accommodate themselves to premises which we must accept.

By the Court.—Order and judgment are affirmed.

APPENDIX "D".

IN SUPREME COURT, STATE OF WISCONSIN

JANUARY TERM, 1943

Nos. 38, 39, 40, 41

No. 38

WISCONSIN GAS & ELECTRIC COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 39

WISCONSIN ELECTRIC POWER COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 40

WISCONSIN MICHIGAN POWER COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 41

THE MILWAUKEE ELECTRIC RAILWAY AND LIGHT COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

Appeals from orders of the Circuit Court for Dane County. August C. Hoppmann, Judge. *Affirmed.*

These were appeals by Wisconsin Gas & Electric Company, Wisconsin Electric Power Company, Wisconsin Mich-

igan Power Company and The Milwaukee Electric Railway and Light Company, pursuant to section 73.015 Stats. to the Circuit Court for Dane County from orders of the Wisconsin Board of Tax Appeals dated November 16, 1939 to the effect that appellants are not permitted by the terms of section 71.03 (4) Stats. to deduct from gross income privilege dividend taxes on dividends declared and paid out of net earnings during 1936. On September 14, 1942 the trial court entered orders affirming decisions dated November 16, 1939 of the Wisconsin Board of Tax Appeals. From these orders the taxpayers appeal.

WICKHEM, J.:

The taxpayers are public service corporations. The privilege dividend tax involved in this case has to do with the income year 1936 in the case of The Milwaukee Electric Railway and Light Company, Wisconsin Electric Power Company, Wisconsin Gas & Electric Company, and that of 1938 of the Wisconsin Michigan Power Company. The situation in respect of the first three companies named is different from that of the last in that the first three companies withheld the privilege dividend tax from the shareholders, whereas Michigan Power Company paid out the dividends and absorbed the tax itself. The contention of the taxpayers is that privilege dividend taxes are deductible from gross income because they are taxes on necessary business and corporate activities. Sec. 71.03 (4) Stats. authorizes the following deductions from the gross income of the corporation:

"Taxes other than special improvement taxes paid during the year upon the business or property from which the income tax is derived, including therein taxes imposed by the state of Wisconsin and the government of the United States as income, excess or war profits and capital stock taxes. • • •"

Article 507, Regulations of the Tax Commission, provides:

"In general, only taxes, other than special improvement taxes, paid during the year upon the business or property

from which the income tax is derived, may be deducted from gross income."

Article 507.5 of the same regulations read:

"Import or tariff duties and business, license, privilege, excise, and stamp taxes, are deductible if incurred in connection with the operation of the taxpayer's trade or business."

Article 520 of such Regulations declares:

"Fees for transferring and registering capital stock are deductible, since such expenses are necessary and related to the production of taxable income."

In the Uniform Classification of Accounts for Electric Utilities prescribed by the Railroad Commission, effective January 1, 1923, operating expenses are thus defined:

"The term operating expenses, as used in this classification, means such expenses as are necessary to the maintenance of the corporate organization, the rendering of service required or authorized by law. * * *"

Included in this classification is a paragraph on other than miscellaneous general expenses and this includes dividend notices, fees of transfer agents, and registrar of stock.

From all the foregoing, taxpayers contend that a tax upon the privilege of declaring dividends is one upon the corporation and constitutes a duty and necessary expense of doing business. Reliance is had upon the case of *J. C. Penney Co.* v. *Wisconsin*, 311 U. S. 435 to the effect that the tax is the return asked for the substantial privilege of carrying on corporate business in Wisconsin, although conditioned upon happenings outside the borders of the state. It is further contended that since the tax wholly depends upon corporate action, it cannot be treated as levied upon the income of shareholders; that it must be paid by the corporation out of earnings otherwise available for distribution.

We are favored with able briefs addressed to the question whether this is a tax upon the corporation, in which case it

is assumed that it must be regarded as an expense of doing business deductible from gross income, or whether it is a tax upon the stockholder. We are not at all sure that all of this argument does not (to paraphrase the opinion of the Supreme Court in the *Penney* case) amount to glossing over the provisions of the statute with commentary and then construing the commentary rather than the text. The real question in this case is: on whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the Supreme Court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend. At this state of the litigation we are not concerned with the question of the power to tax and we must assume that the power vindicated is the power to levy the very tax that was before the Supreme Court for consideration. That power having been sustained, regardless of what the tax be called or where its burdens may be considered to fall, it is immaterial that the Supreme Court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax

as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case. It follows that appellants' contentions must fail.

By the Court.—The orders in each case are affirmed.

APPENDIX "E".

IN SUPREME COURT, STATE OF WISCONSIN,

January Term, 1943.

No. 109

FRANK C. BLIED, Plaintiff and Appellant,

v.

WISCONSIN FOUNDRY AND MACHINE COMPANY, a Wisconsin Corporation, Defendant and Respondent.

Filed June 16, 1943. Arthur A. McLeod, Clerk of Sup. Court, Madison, Wisconsin.

This is an appeal from a judgment of the Circuit Court for Dane County, Alvin C. Reis, Circuit Judge. *Affirmed.*

Action by Frank C. Blied, plaintiff, against Wisconsin Foundry and Machine Company, a Wisconsin corporation, defendant, brought on November 3, 1942 by plaintiff in his own right, and on behalf of others similarly situated, to recover an amount withheld by defendant corporation from preferred stock dividends and paid to State of Wisconsin on account of Wisconsin dividend privilege taxes pursuant to chapter 505, laws of 1935, as amended. Defendant interposed a general demurrer to plaintiff's complaint. On December 12, 1942, judgment was entered sustaining a general demurrer and dismissing plaintiff's complaint. The material facts will be stated in the opinion.

WICKHEM, J.:

Plaintiff, a Wisconsin resident, was the owner of cumulative preferred stock, issued by defendant. The stock was purchased in 1942 with the provision that there would be paid thereon preferential cumulative dividends at the rate of $5.50 per share during such time as the stock should be outstanding, payable out of net profits or surplus applicable thereto, as and when declared by the directors of the defendant. Respondent's principal place of business is the city of Madison and its income is wholly derived from profits and business transacted in the state of Wisconsin. In 1942 defendant declared two semi-annual dividends, each at the rate of $2.25 per share, payable April 1st and October 1st, respectively. Subsequent to each declaration, defendant deducted from the amount of dividend so declared and payable an amount equal to 3% thereof, representing the Wisconsin privilege dividend tax imposed by section 3, chapter 505, Wisconsin Laws of 1935 as amended. In doing this, defendant relied upon the literal provisions of the statute, and asserted that the privilege dividend tax is against the stockholder in respect of the privilege of receiving dividends.

Plaintiff's contentions are that while the language seems to place the tax on the stockholder it must be ignored in view of the fact (1) that the corporation alone is made liable for the tax, (2) that the corporation alone is made liable for the penalty and interest on failure to pay the tax. (3) that no personal liability is imposed upon the stockholder.

It is contended that the United States Supreme Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 construed the tax as one upon corporate earnings and held that the basis of the tax is the privilege to the corporation of doing business in this state. It is further contended that if construed to be one upon the stockholders, the tax is unconstitutional and void because no privileges were conferred by Wisconsin upon the stockholders who are not residents of the state and have neither done business in the state nor declared the dividends which are taxed.

The contentions in this case are identical with those dealt with in *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation; Wisconsin Electric Power Company* v. *Wisconsin Department of Taxation; Wisconsin Michigan Power Company* v. *Wisconsin Department of Taxation; The Milwaukee Electric Railway and Light Company* v. *Wisconsin Department of Taxation*, and the views of the court are sufficiently set forth in the opinion filed in those cases. The decision in *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation; Wisconsin Electric Power Company* v. *Wisconsin Department of Taxation; Wisconsin Michigan Power Company* v. *Wisconsin Department of Taxation; The Milwaukee Electric Railway and Light Company* v. *Wisconsin Department of Taxation* requires that the judgment in this case be affirmed, since the specific requirements of the statute which we hold to be valid are that the tax be withheld and deducted from the dividend payable to a stockholder,

By the Court.—Judgment affirmed.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

INTERNATIONAL HARVESTER COMPANY,

Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,

Respondent.

ON APPEAL FROM THE SUPREME COURT FOR THE STATE OF WISCONSIN

BRIEF OF APPELLANT OPPOSING APPELLEE'S MOTION TO DISMISS APPEAL OR AFFIRM DECISION OF STATE COURT.

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DEMOCRAT PRINTING COMPANY
MADISON, WISCONSIN

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IN THE

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OCTOBER TERM, 1943

No. ----------

INTERNATIONAL HARVESTER COMPANY,

Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,

Respondent.

ON APPEAL FROM THE SUPREME COURT FOR THE STATE OF WISCONSIN

BRIEF OF APPELLANT OPPOSING APPELLEE'S MOTION TO DISMISS APPEAL OR AFFIRM DECISION OF STATE COURT.

Appellee having filed its "Statement Opposing Jurisdiction" of this Court, together with its motion to dismiss Appellant's appeal in the above entitled cause, or to affirm the decision of the Supreme Court of Wisconsin therein, Appellant, in pursuance of Rule 12, paragraph 3, and Rule 7, paragraph 3, of the Rules of the Supreme Court of the United States, files this brief opposing such motion.

I.

THE RECORD PRESENTS FOR DECISION SUBSTANTIAL FEDERAL QUESTIONS WHICH HAVE NOT BEEN RULED UPON BY THIS COURT.

In the preparation of Appellant's "Statement as to Jurisdiction" herein it was conceived that the nature of the case and the federal questions involved were such that it was appropriate to make a rather full analysis of the decision of the Wisconsin Supreme Court here directly involved and of other companion decisions of the Wisconsin Supreme Court in respect to the Wisconsin Privilege Dividend Tax Law. Since Appellee now in its "Statement Opposing Jurisdiction", simply quotes the decision of the State Supreme Court in the instant case we need here only emphasize the logic of that which already appears in Appellant's Statement as to Jurisdiction.

(a) The federal question in respect to the validity of the Wisconsin Privilege Dividend Tax Act as applied to foreign corporations and their non-resident stockholders.

There is here drawn in question the validity of the Wisconsin Privilege Dividend Tax Law. This Court has said that "For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax." (*Wisconsin v. J. C. Penney Co.*, 311 U. S., 435, 444; 85 L. Ed., 267, 270) It is because the "operating incidence" of the Wisconsin privilege dividend tax has been finally and authoritatively determined by the Wisconsin court to be otherwise than conceived by this Court when it sustained that tax in *Wisconsin v. J. C. Penney Company, supra,* that the decision of this Court in that case is not here controlling.

That this Court sustained the Wisconsin Privilege Dividend Tax Law as imposing "an additional tax on corporate earnings

within Wisconsin" though postponing the liability for the tax until such earnings are paid out of dividends, cannot be questioned. The quoted language is taken from the majority opinion of this Court in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 442; 85 L. Ed., 267, 269. That was the effect of the majority opinion of this Court as recited by the minority in that case. The Wisconsin Supreme Court so read the decision of this Court. (*International Harvester Co. v. Wisconsin Department of Taxation*, 243 Wis. 198, 203, 10 N. W. 2d, 169, 171). The District Court of the United States for the Eastern District, and Tax Court of the United States, relied upon this interpretation. (*Wisconsin Gas & Electric Co. v. U. S.*, 46 Fed. Supp., 929, 930, (1942), and *Montreal Mining Co. v. Commissioner*, 2 Tax Court of U. S., No. 85 (Docket No. 106876, decided Sept. 16, 1943).

The Wisconsin Supreme Court, on the other hand, and subsequent to this Court's decision in the *Penney* case, has held in reference to the privilege dividend tax that the tax cannot be considered as an income tax on non-resident stockholders since as such it would be invalid under the Wisconsin Constitution, that "in no sense and to no extent whatever, is it a tax upon the income of the corporation" (*J. C. Penney Co. v. Tax Commission*, 238 Wis. 69, 73, 298 N. W. 186, 188); "held the law to be a privilege tax and not an income tax" (*International Harvester Co. v. Wisconsin Department of Taxation*, 243 Wis. 198; 205, 10 N. W. 2d 169, 171); and determined "(1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business." (*Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216, 220, 10 N. W. 2d, 140, 141).

A further development since the decision of this Court in the *Penney* case is in the formula used by the Wisconsin Department

of Taxation to determine the amount of the dividends attributable to Wisconsin. Mr. Justice Frankfurter noted in his opinion in the *Penney* case that "In the enforcement of this measure against foreign corporations the amount of income attributable to Wisconsin is calculated according to the same formula as that employed in assessing the general corporate income tax paid by such foreign corporations." (311 U. S. 441–442). But in the assessment involved in this appeal, as we shall show specifically under heading (c) of this brief, under the formula adopted by the Wisconsin Department of Taxation and approved by the Wisconsin Supreme Court, the amount of income attributed to Wisconsin is not calculated according to the income tax formula, but on a new and complicated formula utterly unknown to the Wisconsin income tax statute.

The very foundation for this Court's decision in the *Penney* case, sustaining the Wisconsin Privilege Dividend Tax Law, has thus been swept away, and the nature of the case is now such that there is presented the very important and substantial federal question whether the state may impose a tax upon non-resident stockholders of a foreign corporation for the privilege of receiving dividends declared by such foreign corporation,—the dividend being declared and received outside of Wisconsin and under the sanction of laws of sister states,—even though the income traceable to such dividend originated in Wisconsin and grew out of business which the corporation had been licensed by the state to transact.

It is contended by Appellee that there is no conflict between the decision of the Wisconsin Supreme Court here in question and the decision of this Court in *State of Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 85 L. Ed. 267. If that were so, why the diverse results in the lower federal courts in their attempt to construe and apply the Wisconsin privilege dividend tax act, depending upon whether they followed the decision of this Court

in the *Penney* case or followed the subsequent decisions of the Wisconsin Supreme Court in the instant case and in the companion cases decided on the same day? Why in the *Wisconsin Gas & Electric Co. v. United States* did the District Court for the Eastern District of Wisconsin, finding itself bound by this Court's determination in the *Penney* case that "the practical operation of the legislation is to impose an additional tax on corporate earnings within Wisconsin", hold that it was a tax against the corporation and by it deductible for federal income tax purposes; and why did the Circuit Court of Appeals, on appeal in that case, finding that the Wisconsin Supreme Court in the instant case and companion cases had "decided very clearly that the burden of this tax is upon the stockholder and not upon the corporation", reverse the District Court and hold that the Wisconsin privilege dividend tax was not an expense of the corporation, hence not deductible for federal income tax purposes? Why did the Circuit Court of Appeals in that case, on reversing the District Court whose decision had been controlled by this Court's construction of the law in the *Penney* case, say, "The reasoning of that case would seem to sustain the District Court's position." (*Wisconsin Gas & Electric Co. v. United States*, 46 Fed. Sup. 929 (1942); same case, 138 Fed. 2d 597 (November 8, 1943).) (Parenthetically it may be noted that in the case just cited petition for certiorari has been filed with this Court.)

If as asserted by Appellee there was no conflict, why did the United States Tax Court in the *Montreal Mining* case (2 Tax Court, No. 85), following the decision of this Court in the *Penney* case, hold, as did the federal District Court in the *Wisconsin Gas & Electric Co.* case, supra, that the Wisconsin privilege dividend tax was a deductible expense of the corporation?

It is true that the State Supreme Court tried earnestly to reconcile those differences, but only out of supposed compulsion and because it accepted the view that "the determination of the United

States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called." The Wisconsin court nevertheless in the same breath resolutely "(1) insisted upon its exclusive power to construe the law; and (2) held the law to be a privilege tax and not an income tax." (243 Wis. 198, 205; 10 N. W. 2d, 169, 171). In other words, the Wisconsin court boldly declared that "we adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin power to tax is the fact of net earnings in Wisconsin treaceable to the fund distributed by the dividend (243 Wis. 206, 10 N. W. 2d, 172), and "(1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business." (*Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation,* 243 Wis. 216, 220; 10 N. W. 2d, 140).

Notwithstanding such declarations the Wisconsin Supreme Court, confronting the contention "that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied," was forced to conclude:

> "This contention was foreclosed when the Supreme Court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation."
>
> *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation,* 243 Wis. 216, 220.

It is, therefore, clear that it was only under the supposed compulsion of the decision of this Court sustaining the privilege dividend tax, albeit as an income tax against the corporation, that the Wisconsin Supreme Court reconciled its differences with this

Court and accepted the view that Wisconsin has jurisdiction to impose the tax in question.

Viewing the Act here challenged as imposing a tax on the privilege of declaring and receiving dividends against a foreign corporation and its non-resident stockholders, the Wisconsin Supreme Court had previously held in *J. C. Penney Co. v. Tax Comm.*, 233 Wis. 286, 289 N. W. 667:

> "the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected and that Wisconsin was consequently without jurisdiction to levy the tax." (So stated in 243 Wis. 198, 203)

As stated by the Wisconsin Supreme Court in its decision in the instant case this holding had been reached principally on the authority of *Connecticut General Life Ins. Co. v. Johnson*, 303 U. S. 77, where, as the Wisconsin court says:

> "Upon facts which appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax."

Nothing has been said by this Court, so far as we are aware, to shake the authority of the Connecticut General Life Insurance Company case. And now that the Wisconsin Supreme Court has authoritatively determined that the Wisconsin privilege dividend tax is "in no sense and to no extent whatever * * * a tax upon the income of the corporation", but on the contrary (answering the direct question, "On whom is the actual burden of this tax laid", and stating that "This question can have but one answer") has unequivocally declared, "The statute specifically puts it [the tax] upon the stockholder", and to be deducted from *his* dividend, there is presented an important, if not insurmountable, federal question whether the principle of *Connecticut General Life Ins. Co. v. Johnson*, 303 U. S. 77; 82 L. Ed. 673, does not compel this Court to strike down the Wisconsin privilege dividend tax

as applied to a foreign corporation and its non-resident stockholders. In that case Connecticut General Life Insurance Company did business in California under license from that state and entered into contracts with other insurance companies also licensed in California reinsuring them against loss on policies written by them in California on the lives of California residents. The contracts were made in Connecticut, premiums were paid there and the losses were there payable. California imposed a tax on the privilege of the company to do business within California, measuring that tax by gross premiums received. California officials attempted to collect the tax on premiums received by the Connecticut corporation under the reinsurance contracts in question, and the California Supreme Court sustained the tax. On appeal, this Court held that the tax was unconstitutional because it attempted to tax the privilege of doing acts which were not done in California. This Court declared that:

> "* * * there is no basis for saying that reinsurance which does not run to the original insured, and which, from its inception to its termination involves no action taken within California, even the settlement and adjustment of claims, is embraced in any privilege granted by that state." (303 U. S. 82; 82 L. Ed. 673, 678)

Distinguishing the *Connecticut General Life Insurance Company* case this Court, in the *Penney* case, supra, said that in the precise circumstances presented by the record in that case "it was found that the tax, neither in its measure, nor in its incidence, was related to the California transactions." Applying that distinguishing test to the Wisconsin privilege dividend tax as now finally construed by the Wisconsin Supreme Court it may likewise be observed that "the tax neither in its measure nor in its incidence" is related to Wisconsin transactions even though income included in the dividends is traceable to Wisconsin. As now authoritatively construed the tax is against the non-resident

stockholder, measured by and subtracted from his rights to receive payment of dividends declared and paid outside of Wisconsin and under the sanction of laws of sister states.

Application of the doctrine of *Provident Savings Life Assurance Society v. Kentucky*, 239 U. S. 103, 60 L. Ed. 167, will, we submit present the same federal question and ensuing result fatal to the Wisconsin law. Here there was involved a Kentucky privilege tax on a life insurance company which previously had carried on a life insurance business in the state, still continued its contracts on the lives of Kentucky residents, but had withdrawn from Kentucky and thereafter collected premiums on its Kentucky contracts at its home office in New York. This Court held that Kentucky could not lay a privilege tax against the Company, and at page 112, said:

> "Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (*Louisville & J. F. Co. v. Kentucky*, 188 U. S. 385; *Delaware & W. R. Co. v. Penn.*, 198 U. S. 341; *Union Ref. Transit Co. v. Kentucky*, 199 U. S. 194); and the principle involved applies to the assertion of authority on the part of the state to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control."

And continuing at pages 113 and 114 this Court said:

> "There is, however, a manifest difficulty in holding that the mere continuance of the obligation of the policies constituted the transaction of a local business for which a privilege tax could be exacted. As a privilege tax, the tax rests upon the assumption that what is done depends upon the state's consent. But the continuance of the contracts of insurance already written by the company was not dependent on the consent of the state. * * * These policies are contracts already made; the state cannot destroy them or make their mere continuance, independent of acts within its limits, a privilege to be granted or withheld. Neither the con-

tinuance of the obligation in itself, nor acts done elsewhere on account of it, can be regarded as being within the state's control."

There is a striking parallel between this Kentucky case and the case at bar. We have quoted the observation of this Court that the continuance of the contracts of insurance already written by the insurance company was not dependent upon the consent of the state, and for that reason Kentucky was held without power to impose the privilege tax there involved. After the income derived by this Appellant from its Wisconsin business had been realized, discharged of all burden of Wisconsin income taxes, and had become an indistinguishable part of Appellant's funds outside of Wisconsin, the disposition of those funds by appropriate corporate action taken outside of Wisconsin was as independent of the consent of Wisconsin as was the continuance of the life insurance contracts on the Kentucky lives. Indeed, the gap between the earning of the income in Wisconsin and the receipt of the dividend by the non-resident stockholder is even greater, since the privilege of earning is granted by the state to the corporation, whereas the privilege of receiving the dividend, which essentially is the privilege sought to be taxed, is enjoyed by one who may never have transacted business in the state.

The federal question thus presented by application of the unquestioned principles of the *Connecticut General Life Insurance Company* case and the *Provident Savings Life Assurance Society* case to the Wisconsin privilege dividend tax act as now construed by the Wisconsin Supreme Court cannot now be avoided by this Court's placing a construction on that act different from the construction now unequivocally declared by the Wisconsin Supreme Court.

This Court has declared, and all must recognize, that mere labels are not "instruments of adjudication." It has said that "for constitutional purposes the decisive issue turns upon the operat-

ing incidence of a challenged tax." The Wisconsin Supreme Court has now determined this pivotal question, and held the tax to be against the stockholder. This Court has declared that "Ascertainment of the scope of the exaction—what is included in it—is for the state court." (*Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 443, 85 L. Ed. 267.) The Wisconsin Supreme Court has exercised this prerogative and accepted the responsibility.

No doubt this Court may examine for itself and place its own construction on a state law, and in so doing may overrule the construction placed upon the law by the state court, in order to *strike down* the state statute *as an encroachment* upon rights guaranteed by the Federal Constitution. This Court's authority to correct judgments of state courts necessarily is inherent in the duty of this Court to prevent *encroachments* on the Federal Constitution or the *invasion* of rights guaranteed by the Federal Constitution. It is not, however, a function of this Court to review the judgments of state courts for the correction of errors *generally*.

Until this Court's decision in the *Penney* case there was, so far as we are aware, no precedent in which this Court under the due process clause had overruled the highest court of a state in respect to the construction of a state law for the purpose or with the result of *sustaining the state law*. The distinction is vital.

In *Phoenix Insurance Co. v. Gardiner*, 78 U. S. 204, 206; 20 L. Ed. 112, 114, the Court said:

> "* * * Now, we have repeatedly held that the construction of state statutes belongs to the state courts, and is not a Federal question which we can revise in a writ of error to a state court. It is true, if the state court gives such a construction to a state statute as to make it conflict with the Constitution or laws of the United States, and sustains its validity after giving it such construction, and thereby deprives a party of his rights under the said Constitution or laws, then a Federal question is raised, and we can review the decision on the point of the validity of the statute. * * *"

In *Erie R. R. Co. v. Tompkins,* 304 U. S. 64, 79; 82 L. Ed. 1188, 1194, the Court quoted with approval:

> "'* * * Supervision over either the legislative or the judicial action of the States is in no case permissible except as to matters by the Constitution specially authorized or delegated to the United States. Any interference with either, except as thus permitted, is an invasion of the authority of the State and, to that extent, a denial of its independence.'"

In *Rawlins v. Georgia,* 201 U. S. 638, 639; 50 L. Ed. 899, 900, it was said:

> "If the State Constitution and laws as construed by the state court are consistent with the Fourteenth Amendment we can go no further."

In short, while the United States Supreme Court determines for itself the constitutionality of the statute without being bound by the names or labels placed on the tax by the state legislature or the state supreme court, the state supreme court nevertheless is the final authority for determining the actual operation and incidence of the tax. The state supreme court, of course, cannot bind the United States Supreme Court by its *designation* of the nature of the tax nor by the *name* it gives to the tax, but clearly its determination of who pays the tax and of how the tax is collected, is final and binding upon the United States Supreme Court.

The fact unmistakably remains that the Wisconsin Supreme Court has said that the privilege dividend tax is not and cannot be considered an additional tax on corporate income. The Wisconsin Supreme Court has said that the tax cannot be deducted as a corporate expense by the corporation paying the dividend. The Wisconsin Supreme Court has said that under the Wisconsin Constitution an income tax cannot be levied on a non-resident stockholder. The Wisconsin Supreme Court has said that the tax must be withheld from the dividend paid to a non-resident stockholder.

We submit that this Court now takes the tax for its consideration in view of all these developments since its decision in the *Penney* case, and that it must now determine, in view of the decisions of the Wisconsin Supreme Court in respect not merely to the name or label of the tax but as to the actual operation and effect of the law, whether the tax denies federal due process of law.

In the face of the foregoing principles and in the light of the construction unequivocally placed upon the law by the Wisconsin Supreme Court, any action by this Court in placing a different construction upon the state law would constitute the assumption of a prerogative which is inconsistent with our constitutional system of government.

(b) The federal question in respect to the validity of the Privilege Dividend Tax Act as applied to dividends from income accumulated prior to enactment of the law.

The second federal question presented by Appellant's Statement as to Jurisdiction, involving validity of the Privilege Dividend Tax Law as applied to dividends from income accumulated prior to enactment of the law, has not heretofore been submitted to or passed upon by this Court. It assumes that the law is otherwise valid, though obviously in presenting this federal question Appellant does not concede such validity.

Is it possible, within the principles of due process under the Federal Constitution, to sustain the Act in question as imposing a tax upon dividends declared and paid subsequent to the enactment of the law, but from income accumulated by the corporation over an indefinitely long period prior to the enactment? Basically the answer to this question depends upon the determination as to the nature of the tax, whether grounded upon the privilege granted by the state to the corporation of carrying on business in the state, or whether based solely upon the privilege of declaring

and receiving dividends. It is not enough to look at the simple transaction of declaring and receiving dividends; if the law is to be sustained at all as against foreign corporations and their non-resident stockholders it will be on some broader basis than this simple transaction; it is necessary, therefore, to look to whatever foundation has been shoved under the tax structure to support its constitutionality, however unstable and anomalous that may be. The only ground thus far suggested to sustain the tax against foreign corporations and their non-resident stockholders is the privilege granted by the state to the corporation to transact business and derive income in the state; that, it has been said (although before the Wisconsin court had finally determined the tax to be a privilege tax against the stockholder in contrast to an income against the corporation) is the privilege to which the tax bears the requisite fiscal relationship. (*Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 85 L. Ed. 267)

Looking, therefore, to the question of permissible retroactivity of the tax and assuming for the argument that the law is otherwise valid, we find the justification for the tax stated by the Wisconsin Supreme Court thus:

> "We adhere to our determination upon remand of the *Penney Case* that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend." (243 Wis. 198, 206; 10 N. W. 2d, 169, 172)

Though feeling itself compelled to accept the mandate of this Court, the Wisconsin court nevertheless in its decision in the instant case pointed out that this Court had reduced the privilege of declaring and receiving dividends "to mere conditions or contingencies, on the happening of which the tax accrues." In considering the retroactive effect of the tax law regard must be had

to the "jurisdictional fact" or "basis of Wisconsin's power to tax" rather than to the "mere conditions or contingencies upon which the tax may accrue", the more so since such "mere conditions or contingencies", being the declaration and receipt of the dividends, occurred entirely outside the state.

If the state's power to tax the non-resident stockholder of a foreign corporation is to be justified by the privilege granted by the state to that corporation to earn income within the state, then under the decisions of this Court as to the permissible retroactivity of new tax laws the thrust of the tax cannot reach income earned by the corporation prior to the date of enactment of the law. In *Welch v. Henry*, 305 U. S. 134; 83 L. Ed. 87, this Court affirmed the Wisconsin court in sustaining application of the Wisconsin income tax retroactively to "recent transactions", i.e., dividends received in a prior year. Against the objection that the tax because retroactive was a denial of due process, this Court, at page 147, said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. * * * Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process."

Upon the issue of permissible retroactivity of the tax the Wisconsin court, in the instant case, was evenly divided, and the tax assessment against Appellant was accordingly affirmed. On behalf of the three Justices who would limit the retroactive operation of the law it was said:

"(1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax, is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent' transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion." (P. 208)

Even the retroactivity which would have been permitted by the members of the Wisconsin court, whose views are quoted above, would be condemned as arbitrary and lacking due process under the tests laid down by this Court. Thus, for the Wisconsin privilege dividend tax there was no precedent in Wisconsin law, nor so far as we are aware, in the laws of any other state. At no time prior to the initiation of the particular legislative process could that tax have been anticipated. Prior to 1935, while Appellant was exercising the privilege of doing business in Wisconsin and accumulating the surplus from which the dividends in question were later paid there was no intimation of a tax to be imposed *generally* upon residents and non-residents alike upon the *distribution* of Wisconsin income. There was indeed overwhelming precedent in the decisions of the Wisconsin Supreme Court that such a tax could not constitutionally be imposed. (*Newport Co.*

v. Tax Comm., 219 Wis. 293; *State ex rel. Manitowoc Gas Co. v. Tax Comm.*, 161 Wis. 111; *Stone v. Tax Comm.*, 197 Wis. 71)

Mr. Justice Roberts, in the *Penney* case, filed a dissenting opinion in which Mr. Chief Justice Hughes, Mr. Justice McReynolds and Mr. Justice Reed concurred. It was there said:

> "I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders." (P. 446–447)

For the privilege of doing business, granted by Wisconsin to Appellant for the years prior to enactment of the dividend tax, Appellant had met all conditions exacted by the state. The privilege had ripened into vested rights, since the income derived from Wisconsin business, completely discharged from all income taxes, or other charges or restrictions, had been reduced to capital, had been sent outside of Wisconsin, and had become an indistinguishable part of Appellant's funds held beyond the borders of Wisconsin. Such fruits of the privilege granted by Wisconsin were protected from further legislative encroachment. Appropriate to this situation is the following language quoted by this Court in *Coolidge v. Long*, 282 U. S. 582, 603; 75 L. Ed. 562, 570, taken from *Re Craig*, 97 Appellate Division, 289, affirmed 181 N. Y. 551:

> "But when the privilege has ripened into a right it is too late to impose conditions of the character in question, and when the right is conferred by a lawfully executed grant or contract it is property and not privilege, and as such is protected from legislative encroachment by constitutional guaranties."

It is asserted by Appellee that the tax in question is no more retroactive than a tax on capital gains in the year of sale where the asset was acquired years prior thereto. The argument fails since neither federal nor state law attempts to impose a tax on gains accrued prior to the enactment of the income tax law. In both jurisdictions, federal and state, the income tax on capital gains realized subsequent to enactment of the law applies only to such part of the gain as accrues after the enactment. Under the Wisconsin Privilege Dividend Tax law, as here assessed, the tax is applied to surplus accumulated before the date of enactment. Again it is asserted by Appellee that the tax in question is no more retroactive than an income tax imposed upon a stockholder on corporate dividends received by him. This argument illustrates the vice of looking at the tax as a simple transaction tax on the declaring and receiving the dividend rather than on the exercise by the corporation of the privilege of earning in Wisconsin the income from which the dividend is paid, which is the supposed justification for the tax conceived by this Court and reluctantly accepted by the Wisconsin Supreme Court.

(c) The federal question involved in the application of a formula for determining the basis of the tax which is not authorized by the statute.

The third issue also has not heretofore been presented to this Court. It is, briefly, whether the assessment made by the Wisconsin Department of Taxation on a formula not provided for by the Wisconsin Privilege Dividend Tax Act is a denial of due process of law under the Fourteenth Amendment to the Federal Constitution.

The Wisconsin Privilege Dividend Tax Act provides that the proportion of the dividend allocated to Wisconsin shall be ascertained "in accordance with the provisions of Chapter 71." Chap-

ter 71 is the Income Tax Chapter. The Privilege Dividend Tax Act adds that in the absence of proof to the contrary the dividends "shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71 during the year immediately preceding the payment of such dividends."

Chapter 71 provides that in the case of a corporation doing business within and without Wisconsin there shall first be deducted non-apportionable income and that the remaining or apportionable income shall be allocated to Wisconsin on the average of three ratios: The ratio of tangible property in Wisconsin to total tangible property, the ratio of sales in Wisconsin to total sales, and the ratio of cost of manufacturing in Wisconsin to total cost of manufacturing.

It is provided that if the use of any one ratio gives an unreasonable or inequitable final average ratio that ratio may be omitted.

This average ratio is, under the income tax computation, applied to the apportionable net income.

In the privilege dividend tax assessment involved in this appeal the above income tax fraction has been applied by the Wisconsin Department of Taxation to ascertain the portion of the *book* income each year derived from Wisconsin. That is all it is used for. It is dropped out of the computation from that point on. The Wisconsin Department of Taxation proceeded to accumulate such *book* income derived from Wisconsin from year to year. It called the accumulated amount Wisconsin income reflected in surplus.

When a dividend was paid it divided Wisconsin income reflected in surplus by total surplus and multiplied the total dividend paid by this fraction. The result obtained was the amount of the dividend attributed to Wisconsin which was taxed at the regular rate.

It will be seen how far distant this process is from ascertainin the amount of the dividend derived from Wisconsin under th provisions of Chapter 71, the Income Tax Chapter.

In the first place the income tax formula is used only to dete mine the proportion of *book* income in the current year derive from Wisconsin.

In the income tax calculation the income tax fraction is applie against taxable net income, not book net income.

Taxable net income is a very different figure from book ne income. For one thing, reserves are deducted in arriving at boo net income, but not in arriving at taxable net income.

Wisconsin earnings reflected in surplus is neither an income ta figure nor a book figure. It is a figure resulting wholly from computation made by the Wisconsin Department. It is utterl unknown to Chapter 71, the Income Tax Chapter; it is utterl unknown to the Wisconsin Privilege Dividend Tax Act.

Total surplus is a book figure which is not used in the incom tax computation.

Wisconsin earnings reflected in surplus divided by total sur plus is a fraction utterly unknown to the Income Tax Chapter an to the Wisconsin Privilege Dividend Tax Act.

For detailed computation of tax see Exhibit 7a, Rec. 138–14

It is significant, we submit, that the Wisconsin Privilege Divi dend Tax Act provides that if a corporation had a loss for th year prior to the payment of the dividend the Department of Taxa tion "shall upon application" determine the portion of the divi dend "paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." (Wis. Stats. Ch. 71.61(4)). Obviously the application referred to is that of a taxpayer. But there is no such provision for determining the portion of the dividend paid out of surplus

except in the case of a loss and then only in the case of an application by the taxpayer. In the case of a corporation which did not have a loss the ascertainment must be made according to Chapter 71, the Income Tax Chapter. The record shows in this case that there was no loss by the Appellant in any of the years involved. (Exhibit 7A, Rec. 149)

There is no alternative formula provided for in the Income Tax Chapter. The only modification of the income tax formula that may be made is, as we have seen, that one of the three ratios may be dropped out. But there is no provision for substituting a new ratio in place of the one dropped out, much less for substituting an entirely new formula.

Neither is there an alternative formula provided for in the Wisconsin Privilege Dividend Tax statute.

It is obvious that the formula adopted by the Wisconsin Department of Taxation is wholly unknown to the income tax statute and is wholly unknown to the Wisconsin Privilege Dividend Tax statute.

We submit, therefore, that the Wisconsin Department of Taxation has ascertained the amount of the dividends taxed in this case by a process wholly unauthorized either by the Wisconsin privilege dividend tax act or the Wisconsin income tax law.

In the case of *Davis v. Wallace*, 257 U. S. 478, 66 L. Ed. 325, 329, the United States Supreme Court said that where the formula provided for by the statute could not be constitutionally applied the taxing officers were not "at liberty to assess it on another and different basis which the statute shows was not to be applied to corporations in a class to which these railroad companies belong." It added, "Of course we cannot so hold."

Likewise, in *Oklahoma v. Wells Fargo Company*, 223 U. S. 298, 56 L. Ed. 445, a case in which the statutory formula could not constitutionally be applied, Mr. Justice Holmes, writing the opinion, declared that "Neither the court below nor this Court

can reshape the statute simply because it embraces elements that it might have reached had it been drawn with a different measure and intent."

In *Commonwealth v. P. Lorillard Co.*, 105 S. E. 683, 685, the Supreme Court of Appeals of Virginia cited with approval the case of *Oklahoma v. Wells Fargo Co., supra*, and stated that the taxing power:

> "is exerted through the legislature, and an executive officer who seeks to enforce a tax must always be able to put his finger upon the statute which confers such authority. Taxes can only be assessed, levied and collected in the manner prescribed by express statutory authority. Tax assessors have no power to make an assessment except in the manner prescribed by law, and if the statute prescribes a method of assessment which is invalid, the assessor has no power or authority to adopt a method of his own which would have been legal if it had been prescribed by the legislature."

It went on to say "The statute conferred no such authority on them [the taxing officers] and they had no such power", namely, no power to "devise a scheme of their own by which to determine how much of the total income of the defendant in error was derived from business done in this state." It held that "the Legislature alone could exercise this power, and, having failed to do so, no such apportionment can be made. * * *"

In *Dravo Contracting Company v. James*, 114 Fed. (2d), 242, (C. C. A. Fourth Cir.), there was involved a West Virginia gross income tax applying in that case to a contractor constructing locks and dams in West Virginia under a contract with the Federal Government. The court said that it agreed with the taxpayer

> "that the court was without power to apportion its [the taxpayer's] income on the basis of the cost of the activities involved in earning the income within and without the state. No such basis of apportionment is prescribed by statute; and, in the absence of statute, the court is without power to

adopt it, as this is a legislative function involved in the imposition of the tax, and therefore not one which courts may exercise."

This Court denied certiorari in this case. (312 U. S. 678; rehearing denied 312 U. S. 714).

See also:

Fisher v. Standard Oil Co., 12 Fed. 2d, 744, 747.
Ford Motor Co. v. State, 258 N. W. 596, 603. (N. Dak.)

Appellee, in its Statement Opposing Jurisdiction, argues that the formula adopted by the Wisconsin Department of Taxation was approved by the Wisconsin Supreme Court in its opinion in this case and that, therefore, the formula is not now merely a formula of the Wisconsin Department of Taxation, but a formula approved by the Wisconsin Supreme Court.

But the Wisconsin Supreme Court has no more power to evolve a formula not authorized by the statute than the Wisconsin Department of Taxation has. (*Oklahoma v. Wells Fargo Co.*, also *Dravo Contracting Co. v. James*, quoted above)

This Court has emphatically held that a formula which allocates an arbitrary or excessive portion of capital stock value or of net income to the taxing state is a denial of due process of law. This was held as to a state income tax in *Hans Rees' Sons v. N. Carolina*, 283 U. S. 123, 75 L. Ed. 879.

As a formula allocating an excessive amount of income or of capital stock value is a denial of due process of law, a fortiori a formula allocating an amount of dividend derived from Wisconsin under a formula wholly unauthorized by law is a denial of due process. The very essence of due process is taxation according to constituted authority granted by statute and a tax levied on a basis devised by taxing officers without any authority by statute whatever would seem necessarily to be a denial of due process of law.

We submit, therefore, that the use of an unauthorized formula for determining the amount of the dividend attributable to Wisconsin is a denial of due process of law under the Fourteenth Amendment, and the record in this respect presents a substantial federal question.

Dated this 12th day of January, 1944.

Respectfully submitted,

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No. 620

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF WISCONSIN

APPELLANT'S BRIEF

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,

Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF WISCONSIN

APPELLANT'S BRIEF

The case below is reported in 243 Wis., 198; 10 N. W. (2d), 169. Decision on rehearing is not yet printed in official Wisconsin Reports, but appears in 11 N. W. (2d), 95.

Grounds on Which This Court's Jurisdiction is Invoked

The jurisdiction of this Court is invoked under Section 237 of the Judicial Code, to review a final judgment of the Supreme Court of Wisconsin which affirmed a tax under the Wisconsin Privilege Dividend Tax Act (Sec. 3 of Chap. 505, Laws of 1935,

as amended), and sustained the validity of that law as applied to Appellant, a foreign corporation licensed to do business in Wisconsin, and to its stockholders, 98% of whom were not residents of Wisconsin. The tax in question was challenged and the validity of the law as applied to Appellant and its stockholders was drawn in question, upon the grounds that the law, and the tax purported to have been imposed thereunder, deprived Appellant and its stockholders of property without due process of law contrary to the provisions of the Fourteenth Amendment of the Constitution of the United States.

Statement of the Case

The tax affirmed by the judgment of the Wisconsin Supreme Court and involved on this appeal was imposed under the Wisconsin Privilege Dividend Tax Act, Sec. 3 of Chapter 505, Laws of 1935, amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937. The pertinent provisions of the Act are set forth in Appendix A hereto. That Act imposes "for the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in" Wisconsin a tax equal to 2½% (now 3%) of the amount of such dividends declared and paid by all corporations (foreign and local), (with exceptions not here pertinent), after the passage and publication of the Act. The Act requires such tax to be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation; and requires every such corporation made liable for the tax to deduct the amount of such tax from the dividends so declared.

The Act was to "take effect upon passage and publication" on September 26, 1935. It was applied by way of assessment in respect to all dividends declared and paid by Appellant subsequent to that date, notwithstanding a substantial part of the

accumulated Wisconsin income (so-called Wisconsin surplus) from which such dividends were declared and paid had been accumulated prior to the enactment of the law. (R. 34)

Since January 1, 1936, Appellant has been admitted to do business in every state of the Union, except Nevada. It had manufacturing plants and sales branches in many states. The proceeds of all sales and receipts from its operations and business went to Appellant's treasury department in Chicago, Illinois, and were there commingled without segregation or ear-marking, in the general funds of the corporation. (R. 20)

Every act and proceeding in respect to the declaration and payment of all dividends in question took place in Chicago, Illinois, where Appellant's Board of Directors met and declared them and where Appellant's treasury department drew and mailed dividend checks on Appellant's bank accounts representing its general funds on deposit in Chicago and New York. (R. 22) Such dividend checks were there mailed to Appellant's many stockholders, of whom during the period in question there were more than 32,000 in every state of the United States and many foreign countries. Less than 2% of Appellant's stockholders were residents of Wisconsin. (R. 36)

Appellant had outstanding both common stock and preferred stock on which it paid dividends quarterly. (R. 20) Appellant's dividends were not charged against the earnings or profits of any particular class or period, but were charged against surplus which resulted from and reflected the accumulated net profits and income from property wherever located and business wherever transacted. (R. 22) Appellant's charter state is New Jersey, and the applicable laws of that state permit directors of a corporation to pay dividends only from its surplus or from the net profits arising from the business of the corporation, which has been held to be the same as surplus. (R. 20) *National Newark*

etc. Co. v. Durant Motor Co., 1 Atl. (2d) 316; affirmed 125 N. Y. Eq. 435; 5 Atl. (2d) 767.

In prescribing the method for determining the amount of "dividends declared and paid out of income derived from property located and business transacted within the State of Wisconsin", by a corporation doing business within and without the state the Privilege Dividend Tax Act prescribed that "the amount of income attributable to this state shall be computed in accordance with the provisions of Chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend." Chapter 71, which is the Wisconsin Income Tax Law, prescribes the method for determining taxable income of a corporation engaged in business within and without the state, and in that respect requires attribution of certain non-apportionable income, and the apportionment of the balance on the basis of the arithmetical average of three fractions representing, respectively, the ratios of tangible property, of cost of manufacturing, and of sales in Wisconsin to the total of each. (Sec. 71.02 (3) (d) Wis. Stats., set forth as Appendix B hereof.)

The Wisconsin Supreme Court, on remand of the *J. C. Penney case* from this Court, (*J. C. Penney Co. v. Wisconsin*, 238 Wis. 69; 298 N. W. 186), found that the Penney Company had paid its dividends out of surplus as of the end of the prior year rather than from income of that year, and thereupon declared that, "It must be presumed, however, that when it (the Company) drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935, but to the whole amount of the surplus." Accordingly, in the instant case, and solely upon the authority of the above quoted language

of the Wisconsin Supreme Court, the Wisconsin Department of Taxation proceeded to compute the Wisconsin Privilege Dividend taxes against Appellant on a new formula not provided in the statute. (Exhibit 7a, R. 30–36)

The Department found for each year the percentage of Appellant's net income subject to Wisconsin *income tax*. This was found under the formula specified in Chapter 71, the Income Tax Chapter. It applied that percentage to the Appellant's *book income* for the same year. (Exhibit 7a, R. 30–36) Book income, of course, is a very different figure, from taxable income. For one thing, reserves are deducted in arriving at book income which cannot be deducted in arriving at taxable income.

By this method, the Department found the *book income* of Appellant derived from Wisconsin in each year. This *book income* derived from Wisconsin, was accumulated from year to year. The amount so accumulated was called Wisconsin earnings reflected in *surplus*. When a dividend was declared the Department estimated that so much of the dividend was derived from Wisconsin earnings as was found by applying to the dividend the ratio obtained by dividing so-called Wisconsin earnings reflected in surplus by total surplus. (Exhibit 7a, R. 33; R. 13, 14)

The result was taxed at 2½%. (Exhibit 7a, R. 33)

By stipulation, (Exhibit 7a R. 30–36), Appellant agreed that on the assumption that it paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business reflected in its surplus bore to its total surplus, the computation of its Wisconsin privilege dividend taxes as set forth in said Exhibit 7a are correct. However, the Appellant reserved "the right to contest the validity of the privilege dividend tax law as applied to income or surplus accumulated prior to the enactment of said law, or as applied on the presumption that the International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wis-

consin property and business, reflected in its surplus, bore to its total surplus, or as in any manner applied to the petitioner."

The only method specified by the statute would have required the Department to apply to the amount of the dividend the *income tax* fraction of the previous year obtained as the arithmetical average of the ratios of Wisconsin property to total property, Wisconsin sales to total sales, and Wisconsin cost of manufacturing to total cost of manufacturing.

The Wisconsin Department of Taxation included in total surplus on which the challenged tax was calculated, Appellant's surplus at the end of the year 1934, *preceding* the date (September 26, 1935) of the enactment of the Privilege Dividend Tax, amounting to $803,780.72. This figure had been increased by December 31, 1935, following the enactment of the law, to $2,227,499.03. (Exhibit 7a, R. 34) It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26, 1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law.

On the foregoing basis the Wisconsin Department of Taxation applied and assessed against Appellant the 2½% on its dividends declared and paid between December 2, 1935, and October 15, 1937. The tax amounted to $53,713.29 to which there was added penalties and interest to January 1, 1942, of $16,735.60, bringing the aggregate tax, interest and penalties to $70,088.89, all of which are involved on this appeal. (Exhibit 7a, R. 33, 48) The assessment was not made until after Appellant had made payment of the dividends to which it was applicable, and the tax was paid by Appellant under protest. No part of the tax was withheld from dividends. This suit was brought to obtain refund of the amount so paid.

On this factual basis the Wisconsin Supreme Court affirmed the assessments of privilege dividend taxes against Appellant.

Specification of Errors Relied Upon

(1) The Supreme Court of Wisconsin erred in failing to hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, as applied to International Harvester Company, a New Jersey corporation, and its stockholders, especially the non-residents of Wisconsin, under the undisputed facts of the case, was invalid because in effect an imposition of a tax on transactions beyond the State's jurisdiction and hence repugnant to the Fourteenth Amendment of the Constitution of the United States.

(2) The Supreme Court of Wisconsin erred in failing to hold that the assessments of taxes involved in this matter, purporting to have been made in pursuance of the provisions of Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, against International Harvester Company, a New Jersey corporation, under the undisputed facts, operated to take the property of Appellant and of its stockholders, especially the non-residents of Wisconsin, without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

(3) The Supreme Court of Wisconsin erred in failing affirmatively to determine and hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, and the assessments of taxes thereunder against Appellant, insofar as the same operated or were applied to tax the distribution of income or profits of Appellant derived and accumulated prior to the enactment of that law, deprived Appellant and its stockholders of property without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

Summary of Argument

I.

The central contention of the Appellant is that the Wisconsin privilege dividend tax as applied to dividends paid by International Harvester Company, a New Jersey corporation with general offices in Chicago, Illinois, where the dividends were declared by directors at meetings held in Chicago, where the dividends were paid by checks mailed by the treasurer's office of the company in Chicago, drawn on its bank accounts in Chicago and New York, and where more than 98% of its stockholders resided outside of Wisconsin, is a denial of due process of law under the Fourteenth Amendment to the Constitution of the United States.

At the very outset we wish to emphasize that the situation presented in this appeal is different in several crucial respects from the situation presented in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. ed. 267. Because of these differences we submit that the *Penney case* in no way controls this case.

In the *Penney case, supra,* this Court held that the "descriptive pigeon-hole in which the state court puts a tax is of no moment in determining the constitutional significance of the exaction;" that for "constitutional purposes the decisive issue turns on the operating incidence of a challenged tax;" and declared that "the practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends."

Since the *Penney case* was decided, the Wisconsin Supreme Court has made controlling determinations not merely as to the name or label given to the tax, but as to its actual operation.

When the *Penney case* came back to the Wisconsin Supreme Court on remand from this Court, the Wisconsin Supreme Court declared "that it has been consistently held that an income tax

is laid upon the recipient of an income", that the Wisconsin privilege dividend tax "in no sense and to no extent whatsoever is a tax upon income of the corporation", which does not receive the income. It declared that under the Wisconsin constitutional amendment authorizing the levying of income tax, an income tax could not be imposed upon income received by a non-resident stockholder.

In the case of *Blied v. Wisconsin Foundry and Machine Company*, 243 Wis. 221; 10 N. W. (2d), 142, the Wisconsin Supreme Court struck directly at the incidence of the tax. It held that the holder of preferred stock in a Wisconsin corporation could not require that his corporation pay him his dividend free of the Wisconsin privilege dividend tax but that the corporation must deduct the tax from the dividend.

In *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216; 10 N. W. (2d), 140, the Wisconsin Supreme Court held that the tax could not be absorbed as a business expense by the corporation and deducted on its Wisconsin income tax return.

Moreover, in the *Penney case* this Court noted as an argument in support of the view that the Wisconsin privilege dividend tax is an additional tax on corporate income that the proportion of the dividend attributable to Wisconsin was ascertained on the same formula under which net income is allocated to Wisconsin under the Wisconsin income tax. But as we have already shown (page 6) in the case at bar, the proportion of the dividend attributable to Wisconsin has not been ascertained on the "same formula" used in the income tax calculation, but on a new formula unknown to the Wisconsin income tax and the privilege dividend tax, by applying to the dividend the fraction obtained by dividing a figure called Wisconsin income reflected in surplus, or Wisconsin surplus, derived from Wisconsin in prior years, by the total surplus.

This particular argument in favor of the view that the Wisconsin privilege dividend tax is an additional tax on corporate income therefore does not apply to the case at bar.

It is evident, therefore, that the actual incidence and operation of this tax has now been definitely determined by the Wisconsin Supreme Court to be a tax on the stockholder and not on the corporation and that it cannot in its operation and incidence be any longer considered as an income tax either on the corporation or the stockholder.

It must, therefore, be considered as a privilege tax. The case at bar accordingly comes unmistakably under the rule of *Connecticut General Life Insurance Company v. Johnson*, 303 U. S. 77; 82 L. Ed. 673 and *Provident Life Assurance Society v. Kentucky*, 239 U. S. 103; 60 L. Ed. 167, where this Court held that taxes for the privilege of engaging in the life insurance business denied due process of law where the privileges taxed were not exercised in the taxing states.

II.

We submit that on the very ground adopted by the Wisconsin Supreme Court the tax, under accepted principles of due process, cannot be applied to dividends derived from surplus accumulated prior to September 26, 1935. In *Welch v. Henry*, 305 U. S. 134; 83 L. Ed. 87, this Court held that increased rates for an income tax could be applied retroactively only to "recent transactions." (P. 150)

In the case at bar, three of the Justices held that retroactivity "should only be permitted to 'recent' transactions" and that accordingly the privilege dividend tax "may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of the Wisconsin privilege dividend tax."

III.

Finally, Appellant contends that the amount of its dividends derived from Wisconsin, on which the taxes involved in this appeal have been computed, was ascertained on an unauthorized formula. The statute provides that the proportion of dividends derived from Wisconsin shall be found by the income tax formula. The proportion of Appellant's dividends derived from Wisconsin has been found by dividing an amount, called Wisconsin income reflected in surplus, by total surplus and applying the resulting fraction to the dividend. There is no authority in the statute for this method, and Appellant contends that the use of a method unauthorized by the statute is a denial of due process of law.

ARGUMENT

I.

The Wisconsin privilege dividend tax, as now authoritatively construed by the Wisconsin Supreme Court, is a privilege tax against the stockholder, and as applied to Appellant and its non-resident stockholders, takes property without due process contrary to the Fourteenth Amendment of the Federal Constitution.

The challenged judgment of the Wisconsin court affirms a tax imposed under the Wisconsin Privilege Dividend Tax Act. The validity of that Act is here drawn in question, and this Court has said that "for constitutional purposes the decisive issue turns on the operating incidence of a challenged tax." (*Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 444; 85 L. Ed. 267, 270)

We first look to the Act. The first sub-section provides:

> "For the privilege of declaring and receiving dividends, out of income derived from property located and business

transacted in this state, there is hereby imposed a tax equal to 2½% of the amount of such dividends declared and paid by all corporations (foreign and local) * * * after the passage and publication of this Act * * *. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation."

The provision that the tax shall be deducted and withheld from dividends is repeated in sub-sections (2) and (3) of the Act.

"Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission * * *.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared."

(a) The decision of this Court in Wisconsin v. J. C. Penney Co., 311 U. S. 435, (1940) upholding the Wisconsin Privilege Dividend Tax Act, because based on a construction thereof since invalidated, is no longer controlling.

The constitutionality of the Wisconsin Privilege Dividend Tax Act was before this Court on *certiorari* to the Wisconsin Supreme Court in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, and was sustained. That, however, was in 1940, and before the Wisconsin Supreme Court had placed a clear and unequivocal construction upon the law diametrically different from that proposed by this Court to sustain its constitutionality. The decision of this Court in the *J. C. Penney case* is, therefore, not controlling here.

In 1940 when the *J. C. Penney case* was brought to this Court on *certiorari* to the Wisconsin Supreme Court this Court thought that the Wisconsin court had gone no further than to "label", or classify, the Wisconsin Act. Indeed, this Court there expressly

recognized that "ascertainment of the scope of the exaction—what is included in it * * * is for the state court." "But" said this Court, "the descriptive pigeonhole into which the state court puts a tax is of no moment in determining the constitutional significance of the exaction." *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 443; 85 L. Ed. 267.

It is true that at that time the Wisconsin court had determined nothing, had said nothing, as to the *operating incidence* of the tax. Actually all that the Wisconsin court had then done was to hold that the Act "imposed an excise or privilege tax upon the transaction involved of transferring the dividends from the corporation to its stockholders", and to declare:

> "It is agreed on all sides that the tax in question is an excise tax and this Court so held in the *Froedtert case.*" (*J. C. Penney Co. v. Tax Comm.*, 233 Wis. 286, 292; 289 N. W. 677).

When, therefore, there was presented to this Court on *certiorari* to the Wisconsin Supreme Court in *Wisconsin v. J. C. Penney Co., supra,* the question as to the validity of the Privilege Dividend Tax Act, challenged as violative of the due process clause of the Fourteenth Amendment, this Court doubtless approached the issue conscious of the duty to save the law if a constitutional interpretation could be found. Indeed, this Court said: "Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate way of fiscal policy-making." This Court recognized too that the tax in question, if it were to stand, must harmonize with the state's existing taxing system.

Admittedly the language of the Act was ambiguous and open to interpretation in respect to the incidence of the tax, for it imposed the tax "for the privilege of *declaring* and *receiving* divi-

dends." The transaction thus described has a double aspect. It involves not only two distinct acts, but the taxable acts are the acts of different parties, the corporation in *declaring*, the stockholder in *receiving*.

Thus circumstanced, this Court, in a five to four decision, declared:

> "The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the privilege dividend tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."

The Court went on to reason (p. 442):

> "Had Wisconsin, as part of its price for the privileges afforded foreign corporations within its borders, explicitly provided for a supplementary tax on the Wisconsin earnings of such corporations, but postponed liability for the tax until such earnings were to be paid out in dividends, the power of Wisconsin to do so would hardly be questioned."

In ascertaining whether, by the tax in question, property was taken without due process of law, or, in other words, "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state" the Court made this answer:

> "The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax." etc.

The view thus advanced in the majority opinion of this Court that the exaction might be sustained as an additional income tax *against the corporation* is epitomized in its statement of the inquiry "whether Wisconsin has transgressed its taxing power be-

cause its Supreme Court * * * has labeled it a tax on the privilege of *declaring* dividends rather than a supplementary income tax." It is significant that in this statement only the one aspect of the transaction described in the taxing statute is considered, namely, that of *declaring* the dividends, and that is the privilege exercised by the *corporation;* the privilege enjoyed by the *stockholder,* that of *receiving,* is not considered.

That the majority of this Court, in sustaining the Act, had viewed it as an additional tax on corporate earnings within Wisconsin was also the understanding of the minority. Mr. Justice Roberts, writing the minority opinion, said:

> "It is said that the challenged exaction is merely an additional income tax * * * in the view that in testing the constitutionality of an exaction this Court examines for itself the nature and incidence of the tax and disregards mere names and descriptive epithets."

This understanding as to the construction of the Act advanced by the majority in the *J. C. Penney case* was also consistently accepted in the lower federal courts. *Wisconsin Gas & Electric Co. v. U. S.*, 46 Fed. Supp. 929 (Dist. Ct. Eastern Dist. Wis. 1942); *Wisconsin Gas & Electric Co. v. U. S.*, 138 Fed. (2d), 597 (Cir. Ct. of App. 8th Cir., Nov. 8, 1943); *Montreal Mining Co. v. Comm.*, 2 Tax Court of U. S. No. 85, (Docket No. 106876), decided Sept. 16, 1943.[1]

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[1] In *Wisconsin Gas & Electric Co. v. U. S.*, 46 Fed. Supp. 929 (1942) the Federal District Court for the Eastern District of Wisconsin had before it the question whether for federal income tax purposes the corporation was entitled to take a deduction of the Wisconsin privilege dividend tax. (That case is now before this Court on certiorari to the Circuit Court of Appeals for the Seventh District, being No. 565 on the present calendar. It was argued here on March 10, 1944.)

The District Court compared the majority and the minority opinions in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435 and concluded:

> "We would be strongly inclined to agree with the opinion expressed by the minority, but are bound to follow the conclusion of the majority opinion, which states at page 442 of 311 U. S. at page 248 of 61 S. Ct.: '* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general

It, therefore, clearly appears that this Court, while declaring that "ascertainment of the scope of the exaction—what is in-

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income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.'

"These words of the majority opinion cannot be lightly brushed aside. On this point there was a direct and emphatic conflict with the viewpoint of the minority. If the Wisconsin privilege divdend tax 'is to impose an additional tax on corporate earnings', and if 'by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out', then there can be little doubt but that the majority of the Supreme Court held the tax to be on the corporation and not upon the shareholders. It is apparent that the validity of the tax was upheld on that basis." P. 930.

The above quoted decision of the District Court was appealed by the government to the Circuit Court of Appeals, (7th Cir.), but pending such appeal the Wisconsin Supreme Court rendered its decision in the instant case, *International Harvester Co. v. Wisconsin Department of Taxation*, 243 Wis. 198, and in the compa.ion cases of *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216, and *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221. In view of those decisions of the Wisconsin court, the Circuit Court of Appeals reversed the District Court and held that the corporation was not entitled, in determining its federal income tax, to deduct the Wisconsin privilege dividend tax. See *Wisconsin Gas & Electric Co. v. U. S.*, 138 Fed. (2d) 597, decided November 8, 1943.

However, the Circuit Court of Appeals recognized that at the time the District Court decided the case the Wisconsin Supreme Court had not decided the cases just cited, but had relied on the decision of this Court in the *J. C. Penney case*, and of this the Circuit Court of Appeals said: "The reasoning of that case would seem to sustain the District Court's position."

In *Montreal Mining Co. v. Commissioner*, 2 Tax Court, U. S. No. 85, decided September 16, 1943, there was involved the question of deductibility of the Wisconsin privilege dividend tax for purposes of federal income tax, the same question as is presented in the *Wisconsin Gas & Electric Co. case, supra*. The tax court's decision was rendered subsequent to the Wisconsin cases above noted, but prior to the decision of the Circuit Court of Appeals in the *Wisconsin Gas & Electric Co. case*. The commissioner there contended that the privilege dividend tax is a levy upon the stockholders and consequently should be disregarded entirely in the taxation of a corporation's income. The Tax Court quoted from this Court's decision in the *J. C. Penney case* to the effect that practical operation of the legislation was to impose an additional tax on corporate earnings within Wisconsin and concluded:

> "Thus, it is apparent that the tax in question was there determined to be a levy on corporate income. Upon the authority of that decision, we hold in petitioner's favor on this issue. The tax is deductible under section 23 (c) of the Revenue Acts of 1934 and 1936."

See also opinion in the instant case rendered by Judge Alvin C. Reis, Circuit Judge. That opinion is set forth at Record pages 48–56. Judge Reis said (R. 50): "When, however, this case [*J. C. Penney case*] reached the Supreme Court of the United States, that tribunal regarded this tax as a 'supplementary income tax' upon the corporation and hence clearly within the power of the state to impose and not fringing upon the Fourteenth Amendment."

cluded in it * * * is for the state court", but finding that the state court had not *construed* the law to the extent necessary to enable this Court to apply the tests for determining whether it operated to take property without due process under the Fourteenth Amendment, itself held out a possible construction of the law which would bring it within the principles of due process under the Fourteenth Amendment.

This did not preclude the Wisconsin court from declining to accept the construction thus proffered by this Court, it did not preclude the state court from placing upon the Act its own authoritative construction fixing the actual incidence and burden of the tax. Indeed, this Court has conclusively held that while it determines whether a state statute violates the federal constitution by considering its actual operation and incidence irrespective of the name or label which either the state legislature or the state court may have given the statute, nevertheless the state supreme court determines finally the actual operation of the statute.

The state supreme court determines who pays a tax, how the tax is collected, and on whom the tax is a burden.

In *J. Bacon & Sons v. Martin*, 305 U. S., 380; 83 L. Ed., 233, the Appellant contended that a Kentucky statute imposing a tax on the "receipt" of cosmetics in the state by any Kentucky retailer was a burden on interstate commerce as applied to articles purchased by him from manufacturers and dealers in other states and transported to the Appellant's place of business in Kentucky. The Court of Appeals of Kentucky had construed the statute to define "receipt" as meaning not only the act of receiving cosmetics, but the sale and use of cosmetics after the retailer had received them, and that the excise tax was imposed on such sale and use after receipt.

This Court said "the construction of the statute by the state Supreme Court is binding upon us."

In *Federal Land Bank of St. Paul v. Bismark Lumber Co.*, 314 U. S., 95; 86 L. Ed., 65, the question involved was whether a federal land bank was subject to the state sales tax on purchases of materials for use in repairing and improving buildings and fences on farm lands acquired by the bank through foreclosure of farm mortgages, the bank claiming exemption as a federal instrumentality.

This Court said that it was clear that the North Dakota statute made the purchaser of land, there the federal land bank, liable for the sales tax. It said that the Act required the retailer to add the sales tax to the sale price and declared the tax to be a debt from the consumer to the retailer. This Court noted that the North Dakota Act made it unlawful for the retailer to hold out that he would absorb or refund the tax in whole or in part. It added that the Supreme Court of North Dakota has held that the sales tax is laid on the purchaser, and said: "these determinations of the incidence of the tax by the state court are controlling and respondents concede the point."

This Court will, of course, apply the state law as construed by the state courts as of the time when the appeal is disposed of rather than as of some earlier date, as though in the meantime the state legislature had amended the law. It will, moreover, abandon its former decision construing a state statute if the state courts have subsequently given to it a different construction.

Vanderbark v. Owens Illinois Glass Co., 311 U. S. 538; 85 L. Ed., 327, 330.

Green v. Lessee of Neal, 6 Peters, 291; 8 L. Ed., 402.

Fairfield v. Gallotin County, 10 Otto, 47; 25 L. Ed., 544, 546.

While, therefore, this Court is the final authority for determining whether the tax in its actual operation violates the due

process clause of the Fourteenth Amendment, we submit that this Court clearly accepts the operating incidence of the tax as determined by the state supreme court in its consideration of the constitutional question.

What then the state supreme court calls the tax, whether income, privilege or property tax, is not conclusive on this Court. But who pays the tax, who collects the tax, on whom the tax is a burden,—these questions clearly are finally determined by the state supreme court.

Since the decision of this Court in the *Penney Case*, there have been vital determinations made by the Wisconsin Supreme Court as to the actual incidence of this tax which we submit, together with other factors which we will present below, make the situation presented here materially different from that presented to this Court in the *Penney Case* and prevents the *Penney Case* from in any way determining the issues in this case.

(b) The Wisconsin Supreme Court, exercising its acknowledged function to construe the state law, denied that it was an income tax on corporate earnings, and declared it to be a privilege tax against the stockholder.

Subsequent to this Court's decision in the *J. C. Penney case, supra*, the Wisconsin Supreme Court, at its first opportunity, insisted upon its acknowledged right to construe the Privilege Dividend Tax Act and to set at rest the incidence of the tax. In so doing the Wisconsin court unequivocally refused to accept the construction proffered by this Court, and placed its own construction upon the Act consistent with the Wisconsin Constitution and existing tax structure.

Upon remand in the *J. C. Penney Case* the Wisconsin court noted the language of this Court that "the practical operation of this legislation is to impose an additional tax on corporate

earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends", but declared in explanation of its previous characterization of the law (p. 72):

> "Inasmuch as the legislature expressly declared the tax to be for the 'privilege of declaring and receiving dividends', we denominated it an excise or privilege tax. *State ex rel. Froedtert G. & M. Co. v. Tax Comm.* (1936), 221 Wis., 225, 233; 265 N. W. 672, 267 N. W. 52."

The Wisconsin court then prefaced its further exposition of the law by this statement of principles:

> "As we understand the law our construction of the state statute is conclusive upon the Supreme Court of the United States. *Erie R. Co. v. Tompkins* (1938), 304 U. S. 64; * * *; *Swift v. Tyson* (1842), 16 Pet. 1 * * * See Note 83 L. Ed., 518."

Then by way of definition and construction of the Act the Wisconsin court proceeded:

> "It is perfectly true that the tax cannot be sustained as an income tax under the law of this state. Under our constitutional amendment authorizing the levying of an income tax, sec. 1, art. VIII, Const., it has been consistently held that an income tax is a burden laid upon the recipient of an income and the amount of the tax is measured by the amount of the income. *State ex rel. Sallie F. Moon Co. v. Wis. Tax Comm.* (1917) 166 Wis. 287, 163 N. W. 639, 165 N. W. 470. Under its laws this state cannot and it does not undertake to tax the income of citizens of other states who are not doing business in this state. Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not *a tax on the pri-*

> *ilege of declaring and receiving a dividend as we hold it to be,* then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof. In no sense and to no extent whatever, is it a tax upon the income of the corporation." (Emphasis supplied)

Notwithstanding the Wisconsin Court's construction of the Act, and its refusal to accept the construction proffered by this Court, the state court upon remand in the *J. C. Penney case* considered that it was bound by this Court's determination as to Wisconsin's jurisdiction to levy the tax in question, and it yielded upon that ground only, steadfastly insisting "that to construe the statute * * * is a matter under the decisions of the Supreme Court of the United States which is clearly a function of this (Wisconsin Supreme) Court * * *."

In *Wisconsin v. J. C. Penney Co., supra;* this Court, reiterating the principle of numerous earlier decisions, stated the "guiding formulation for adjudicating a tax measure":

> "* * * in passing on its constitutionality we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it."

And again, more concretely:

> "For constitutional purposes the decisive issue turns on the operating incidence of the tax."

So it was that following the *J. C. Penney case* the Wisconsin Supreme Court had occasion in several cases to determine "the practical operation" the "operating incidence" of the Privilege Dividend Tax.

Besides the instant case there were *Blied v. Wisconsin Foundry and Machine Company,* 243 Wis., 221; 10 N. W. (2d) 142, and *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation,* 243 Wis., 216; 10 N. W. (2d) 140. The

decisions in all of these cases were rendered on the same day, June 16, 1943. The decision in the instant case, as well as in the other two cases referred to, and rendered at the same time, have been set forth in the "Statement as to Jurisdiction" in this case.

Blied v. Wisconsin Foundry & Machine Company, supra, involved a suit by a preferred stockholder against his corporation to recover an amount withheld by the corporation from the preferred stock dividends and paid to Wisconsin on account of its privilege dividend tax. Plaintiff contended that under the decisions the tax was not against the stockholder, but against the corporation, since the corporation alone was made liable for the tax, was liable for the penalty and interest on failure to pay the tax, and since no personal liability was imposed upon the stockholder. The court stated the plaintiff's case thus:

> "It is contended that the United States supreme court in *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, 61 Sup. Ct. 246, 85 L. Ed. 267, construed the tax as one upon corporate earnings, and held that the basis of the tax is the privilege to the corporation of doing business in this state. It is further contended that if construed to be one upon the stockholders, the tax is unconstitutional and void because no privileges were conferred by Wisconsin upon the stockholders who are not residents of the state and have neither done business in the state nor declared the dividends which are taxed."

These contentions, the court said were identical with those dealt with in *Wisconsin Gas & Electric Co. v. Department of Taxation, supra,* and reference was made to the decision in that case as controlling. Judgment was affirmed dismissing the complaint for the reason that

> "the specific requirements of the statute which we hold to be valid are that the tax be withheld and deducted from the dividends payable to the stockholder."

In *Wisconsin Gas & Electric Co. v. Department of Taxation, supra,* which was held to control *Blied v. Wisconsin Foundry and Machine Company, supra,* the question was whether the Wisconsin privilege dividend tax paid by the corporation was a proper deduction from gross income in ascertaining the Wisconsin income tax. The taxpayer there, as in the *Blied Case, supra,* contended that the tax upon the privilege of declaring dividends was upon the corporation and constituted a duly and necessary expense of doing business. For this contention the taxpayer relied upon the decision of this Court in *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435; 85 L. Ed. 267, to the effect that the tax was "the return asked for the substantial privilege of carrying on corporate business in Wisconsin, although conditioned upon happenings outside the borders of the state." Upon the question whether the privilege dividend tax was upon the corporation the Wisconsin court said (p. 219):

> "The real question in this case is: On whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the supreme court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the United States Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the

> dividends declared and benefits to the stockholder who has received a dividend. At this stage of the litigation we are not concerned with the question of the power to tax and we must assume that the power vindicated is the power to levy the very tax that was before the United States supreme court for consideration. That power having been sustained, regardless of what the tax be called or where its burdens may be considered to fall, it is immaterial that the United State supreme court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) That the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney Case, supra.* It follows that appellants' contentions must fail."

The Wisconsin Supreme Court in its decision in the instant case did not find it necessary further to dwell upon the point, unequivocally decided by it in the *Blied case,* and in the *Wisconsin Gas & Electric case, supra,* that the tax was against the stockholder and deductible from the dividends due him. That court did, however, in various forms reiterate its previous determination that the tax is "a privilege tax and not an income tax." Entirely disregarding its unequivocal determination that the exaction is in no sense an income tax and not a tax against the corporation, and that the incidence of the tax is upon the stockholder, indeed, without any regard to the incidence of the challenged exaction, the Wisconsin Supreme Court in the instant case interprets the decision of this Court in the *J. C. Penney case* to hold as the *"jurisdictional fact"* justifying the tax that the corporation paid dividends in whole or in part

out of property located in this state or business transacted here, and that

> "the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from these activities are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the Federal Supreme Court (of the United States) has reduced the privilege feature of the tax to mere conditions and contingencies upon the happening of which the tax accrues."

This bare statement of the supposititious basis of Wisconsin's power to tax is the ultimate concept of that power *forced* upon the Wisconsin court by its supposed necessity of accepting this Court's mandate that Wisconsin had power to pass the precise tax Act before it, but without any corresponding necessity on the part of the state court of accepting this Court's construction of the Act. The statement, therefore, discards those supports which this Court offered by way of construction of the Act, but which the state court, in the exercise of its acknowledged function to construe the state statute, refused to accept. This statement of the supposed basis of power to tax therefore ignores, because the Wisconsin court refused to accept it, the very foundation which this Court had attempted to lay under the dividend tax, namely, that it was an additional tax on corporate earnings, a supplementary income tax against the corporation. We submit that the Wisconsin Supreme Court, by such an interpretation of the decisions of this Court has assumed, however unwillingly, to commit this Court to a doctrine of state taxing power so broad in scope, so dangerous in concept, and so at war with all precedents, as to be utterly untenable.

It thus becomes clear from the decisions of the Wisconsin Supreme Court upon remand in *J. C. Penney Co. v. Tax Comm.*,

238 Wis., 69, 298 N. W. 186 and in the more recent cases of *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis., 221; 10 N. W. (2d) 142, *Wisconsin Gas & Electric Co. v. Department of Taxation*, 243 Wis., 216; 10 N. W. (2d) 140 and in the instant case, that the Wisconsin Supreme Court has flatly and stoutly refused to accept this Court's proffered construction of the Wisconsin Privilege Dividend Tax Act as an additional or supplemental income tax against the corporation on account of its earnings in Wisconsin. The Wisconsin court has steadfastly insisted upon its acknowledged right to construe the statutes of the state. It has now, as it had not at the time (Dec. 16, 1940) when this Court decided *Wisconsin v. J. C. Penney Co., supra*, unequivocally determined that the tax is not an income tax and as such could not be sustained under the Wisconsin law; that if it were an income tax at all then under the provision of the Wisconsin Constitution for the levy of income taxes it would be against the stockholder, and Wisconsin cannot tax the income of citizens of other states who are not doing business in Wisconsin; specifically "that in no sense and to no extent whatever is it a tax upon the income of the corporation;" and that the exaction "is as the legislature declared it to be, a privilege or excise tax upon the transaction of declaring and receiving dividends", and is, moreover, imposed upon the stockholder and required to be withheld and deducted from his dividends.

(c) The Wisconsin court has now so fully and unequivocally construed the Act as to yield to tests of constitutionality declared by this Court; so tested the Act is condemned as an attempt to tax privileges enjoyed elsewhere and neither granted nor controlled by Wisconsin.

The Wisconsin court, therefore, has now decided everything needed to demonstrate the *practical operation* of the legislation; it has unequivocally determined the "operating incidence" of

the challenged tax. Accordingly, the Wisconsin court now, by its decisions, has construed the act of its legislature, with the same effect as though written in by the legislature itself, so as to embody in that legislation definite answers to all of these tests laid down by this Court for determining the constitutional validity of the challenged tax. (See *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 443; 85 L. Ed. 267). The construction so written into the law by the Wisconsin court is diametrically opposed to that interpretation placed on the Act by this Court in the *J. C. Penney Company case* for the purpose of sustaining the law.

Summarizing, the Wisconsin Supreme Court since the *Penney case* has made the following determinations as to who pays the tax and on whom it is a burden, in other words, the "operating incidence" and the "practical operation":

The tax is not on income received and therefore cannot be an additional corporate income tax, since an income tax in Wisconsin is laid only on income received.

The corporation paying the dividend is required to withhold the tax from the dividend and may not absorb it as a business expense.

The corporation cannot deduct the tax as a business expense on its Wisconsin income tax return.

The tax is imposed on the stockholder and under the Wisconsin Constitution it would not be constitutional as a tax on income of nonresident stockholders.

All these determinations we submit are final and binding on this Court under the decisions above cited.

Moreover, the tax is not calculated under the income tax formula.

Finally, and as a further indication of the changed situation since the *Penney case* was decided by this Court, we submit as a

further argument against the designation of this tax as a tax on income that the tax assessed against Appellant, and involved on this appeal, was not assessed on the income tax formula as had been done in the *Penney case.*

This Court noted in its opinion in the *Penney case* (p. 441) that:

> "In the enforcement of this measure against foreign corporations, the amount of income attributable to Wisconsin is calculated according to the same formula as that employed in assessing the general corporate income tax paid by such foreign corporations."

We shall consider the formula adopted in assessing the tax on this appeal more particularly below but at this point we wish merely to note that the formula on which the tax against the International Harvester Company was assessed is not the same formula as that used in the Wisconsin Income Tax.

The Wisconsin Income Tax is assessed by applying to the apportionable net income of a corporation doing business within and without Wisconsin the average of three ratios: (1) the ratio of Wisconsin tangible property to total tangible property; (2) the ratio of Wisconsin cost of manufacturing to total cost of manufacturing; (3) the ratio of Wisconsin sales to total sales. The average of these three ratios is applied to total apportionable net income subject to income tax.

This is the income tax formula and this was the formula applied to the *Penney case*. This formula has not been used in the case at bar.

The proportion of the Appellant's dividends attributable to Wisconsin has been found by dividing so-called Wisconsin income reflected in *surplus* by total *surplus* and applying the resulting fraction to the total dividend.

It is obvious that the proportion of the dividend taxed is not found on the income tax formula and therefore, the assumption

that the tax is an additional corporate income tax because the income tax formula is used, does not apply to the taxes on this appeal.

We submit therefore that this Court now takes the tax for its consideration in the light of these controlling determinations made by the Wisconsin Supreme Court, since the *Penney case* was decided, and that it is now for this Court to determine in the light of these decisions of the Wisconsin Supreme Court as to the actual operation and burden of the tax, whether the tax denies due process of law under the Fourteenth Amendment.

A tax which is not paid by the corporation, which is not based on income of the corporation, which cannot be deducted, as an expense from income received by the corporation, and which must be withheld from dividends paid to the stockholders, bears no resemblance to a corporate income tax. And as an income tax on the non-resident stockholders it would be unconstitutional. Therefore, in the light of the above determinations we submit that this Wisconsin privilege dividend tax can no longer be treated as an income tax, either on the corporation or on the non-resident stockholder.

With the foundation for this Court's decision in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, swept away, and that case no longer controlling in respect to the validity of the Wisconsin privilege dividend tax, the principles announced by this Court in *Connecticut General Life Insurance Co. v. Johnson*, 303 U. S., 77; 82 L. Ed., 673, are now controlling and require this Court to strike down the Wisconsin Act as applied to foreign corporations and their non-resident stockholders. In that case Connecticut General Life Insurance Company did business in California under license from that state, and in addition to such local business entered into contracts with other insurance companies also licensed in California reinsuring them against loss

on policies written by them in California on the lives of California residents. The reinsurance contracts were made in Connecticut, premiums were paid there and the losses, if any, were there payable. California imposed a tax upon the privilege of the company to do business within California, measuring that tax by gross premiums received. California officials attempted to collect the tax on premiums received by the Connecticut corporation under the reinsurance contracts in question, and the California Supreme Court sustained the tax. On appeal this Court held that the law was unconstitutional because it attempted to tax the privilege of doing acts which were not done in California. In answer to the argument that because the reinsurance transactions were so related to business carried on by the Insurance Company in California as to be a part of it and properly included in the measure of the tax, this Court said (p. 80):

> "But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state. As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." (Citing ten U. S. Supreme Court decisions)

This Court then used the following pertinent language, equally appropriate to the instant case:

> "It follows that such a tax, otherwise unconstitutional, is not converted into a valid exaction merely because the cor-

poration enjoys outside the state economic benefits from transactions within it, which the state might but does not tax, or because the state might tax the transactions which the corporation carries on outside the state if it were induced to carry them on within."

The Court pointed out that apart from the fact that the Insurance Company in that case was privileged to do business in California, and that the risks reinsured were originally insured against in California by companies also authorized to do business there, California had no relationship to the Insurance Company or to the reinsurance contracts. Again this Court used language equally appropriate to the case at bar:

> "No act in the course of their (contracts') formation, performance or discharge, took place there. The performance of those acts was not dependent upon any privilege or authority granted by it, and California laws afforded to them no protection.
>
> The grant by the state of the privilege of doing business there and its consequent authority to tax the privilege do not withdraw from the protection of the due process clause the privilege, which California does not grant, of doing business elsewhere."

In *Wisconsin v. J. C. Penney Co., supra,* the dissenting opinion, considering the Wisconsin privilege dividend tax was an excise tax upon a privilege exercised outside of Wisconsin and laid upon the stockholder, said:

> "Upon the facts, a tax is levied on what lies outside the sovereignty of Wisconsin. Its attempted collection is a violation of the Due Process Clause of the Fourteenth Amendment and should be stricken down.
>
> The Supreme Court of Wisconsin could not have decided otherwise in the light of a recent expression of this court on the subject. In reaching its decision it professedly followed and applied *Connecticut General Life Insurance Co. v. Johnson,* 303 U. S. 77."

There can no longer be any dispute that the tax in question is exactly what the minority in the *J. C. Penney case* took it to be. The Wisconsin Supreme Court has in the meantime unequivocally construed it that way. The observations contained in the dissenting opinion, above quoted, are therefore completely applicable.

As suggested by the language of the dissenting opinion in the *J. C. Penney case, supra,* the Wisconsin court, when the *Penney* case was first before it:

> "* * * held that in its application to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin, the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax."

As later explained by the Wisconsin court in its decision in the instant case, for the principle just quoted,

> "This court (Wisconsin Supreme Court) relied principally on the case of *Connecticut General Life Ins. Co. v. Johnson,* 303 U. S. 77, where upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax", etc.

Equally applicable to the case at bar, and likewise fatal to the Wisconsin Privilege Dividend Tax, are the principles stated by this Court in *Provident Savings Life Assurance Society v. Kentucky,* 239 U. S. 103; 60 L. Ed. 167.

That case, involving a privilege tax on a life insurance company which previously had carried on a life insurance business in Kentucky, still continued its contracts on lives of Kentucky residents, but had withdrawn from Kentucky and thereafter collected premiums on its Kentucky contracts at its home office in New York. This Court held that Kentucky could not lay a privilege tax against the Company, saying:

"Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (*Louisville & J. F. Co. v. Kentucky*, 188 U. S. 385; *Delaware & W. R. Co. v. Penn.*, 198 U. S. 341; *Union Ref. Transit Co. v. Kentucky*, 199 U. S. 194); and the principle involved applies to the assertion of authority on the part of the state to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control." (P. 112)

The Court continued:

"There is, however, a manifest difficulty in holding that the mere continuance of the obligation of the policies constituted the transaction of a local business for which a privilege tax could be exacted. As a privilege tax, the tax rests upon the assumption that what is done depends upon the state's consent. But the continuance of the contracts of insurance already written by the company was not dependent on the consent of the state. * * * These policies are contracts already made; the state cannot destroy them or make their mere continuance, independent of acts within its limits, a privilege to be granted or withheld. Neither the continuance of the obligation in itself, nor acts done elsewhere on account of it, can be regarded as being within the state's control." (Pages 113–114)

Between this Kentucky case and the case at bar there is a striking parallel. We have quoted the observations of this Court that the continuance of contracts of insurance previously written by the Insurance Company was not dependent upon the consent of the state, and for that reason Kentucky was held without power to impose the privilege tax there involved. After the income derived by Appellant from Wisconsin business had been realized, and was forwarded to its home office in Illinois discharged of whatever tax had been imposed by Wisconsin upon its receipt, such funds became a portion of the general mass of Appellant's property, held and administered at its general office in Chicago.

The disposition of those funds by appropriate corporate action taken outside of Wisconsin was as independent of the consent of Wisconsin as was the continuance of life insurance contracts on the Kentucky lives. Indeed, the gap between the earning of the income in Wisconsin and the receipt of dividends by Appellant's non-resident stockholders is even greater, since the privilege of earning is granted by Wisconsin to the corporation, whereas the privilege of receiving the dividend, which essentially is the privilege here sought to be taxed, is enjoyed by one who may never have transacted business in the state.

Especially appropriate to the corporate funds derived by Appellant from its Wisconsin property and business after such funds had become a part of the general mass of the corporation's property held outside of Wisconsin, are these observations found in the dissenting opinion in the *J. C. Penney case* (p. 448):

> "The funds may be employed in the extension of its business; they may be held as insurance against future business losses or they may be distributed to its stockholders in dividends. Their management and their disbursement have no relation to the original receipt of income save only the fact that, like most property, they are built up as the fruits of income. Their use and their disbursement does not depend on any law of Wisconsin and cannot be controlled by any such law. The act of disbursing them, whether in payment of corporate obligations or as dividends, is one wholly beyond the reach of Wisconsin's sovereign power, one which it cannot effectively command, or prohibit or condition. That distribution cannot be the subject of an excise tax by the State of Wisconsin."

We think it was well said in the dissenting opinion in the *Penney case*, 311 U. S. 435, 447; 85 L. Ed. 267, "one cannot intelligently discuss things or acts except by using the names commonly employed to describe them. Concepts of ad valorem taxa-

tion on property and taxation of income, are clearly and easily discriminable."

In short, there must be some order and system in taxation and it is practically impossible to consider the constitutionality of a taxing statute, either state or federal, without examining the nature of the tax involved, not according to its mere name or label, but according to its actual operation or incidence.

From the very beginning this Court has found it necessary in considering the constitutionality of federal and state taxing statutes to classify taxes. As early as *Hylton v. U. S.*, 3 Dallas, 171; 1 L. Ed. 556, this Court held that a tax on carriages was not a direct tax on carriages as property, which, under the Constitution, would have to be apportioned according to population, but was an excise tax. This Court many times has had before it a tax which might be considered either a privilege tax or a property tax, and the determination of the character of the tax by its actual operation and incidence has been vital to the determination of the constitutionality of the tax.

For example, in *East Ohio Gas Co. v. Tax Commission*, 283 U. S. 465; 75 L. Ed. 1171, this Court said (p. 470): "Admittedly the exaction is not a tax on property or in lieu of a property tax." It said that the statute "calls it, and in fact, it is, a tax for the privilege of carrying on intrastate business." The Court held that the tax was applied to gross receipts wholly from intrastate business and therefore upheld the tax.

We refer also to *Pullman Co. v. Richardson*, 261 U. S. 330, 67 L. Ed. 682; *Hopkins v. So. Cal. Tel. Co.*, 275 U. S. 393, 72 L. Ed. 329; and *Galveston, Harrisburg & San Antonio Ry. Co. v. Texas*, 210 U. S. 217; 52 L. Ed. 1031. In each of these cases the court found it necessary to consider whether the tax was a property tax, or a privilege tax on gross receipts, for the purpose of determining its constitutionality.

But in whatever class the Wisconsin Privilege Dividend Tax is placed, we submit that it cannot be sustained on this appeal.

We have already conclusively shown that it can no longer be treated as an income tax.

We have also just shown that it cannot be constitutional as a privilege tax on the privilege of declaring and receiving dividends.

Clearly it would not be constitutional as a tax on the fund from which the dividends are paid since that fund was located entirely outside of Wisconsin. That fund was derived from earnings of prior years, and it was an intermingled fund in which the earnings of prior years had lost their identity. The dividends were not only paid out of that surplus, but the dividends paid in 1937 were *necessarily* paid out of surplus since there was not sufficient book income in the fiscal year ending October 31, 1936, to provide for the dividends paid in 1937. In 1937 total dividends amounting to $21,268,811.92 were paid. The book income of Appellant in 1936 was only $18,948,047.35. (Ex. 7a, R. 33, 34)

We submit that no one would contend that if funds of a taxpayer partly derived from Wisconsin earnings are used to purchase a building in Chicago or New York, that Wisconsin could impose a property tax on a portion of the value of the building, nor would anyone contend that a portion of the rents received by the taxpayer from outside tenants of that building could be taxed by Wisconsin.

To summarize:

With the abandonment of the hypothesis that the Privilege Dividend Tax might be treated as a supplemental income tax on corporate earnings in Wisconsin, with that support to the Wisconsin power to impose the tax swept away, the exaction is disclosed to be, what appears from the very face of the law, an attempt to impose a privilege tax against stockholders, whether resident or non-resident, on the declaration and receipt of divi-

dends. This, as to Appellant, a foreign corporation, and its stockholders, of whom more than 98% reside outside of Wisconsin, must be condemned as an attempt by Wisconsin to exact a tax for a privilege which Wisconsin does not grant and which it can neither condition nor control. Such an attempted exaction falls squarely within the prohibition of the Fourteenth Amendment to the Constitution of the United States.

II.

The Privilege Dividend Tax Act, and assessments here challenged, if valid at all, are nevertheless fatally retroactive and operate to take property without due process contrary to the Fourteenth Amendment.

Even should the Privilege Dividend Tax Act be otherwise sustained, the Act and the taxes here challenged are fatally retroactive and hence violate the due process provisions of the Fourteenth Amendment to the Federal Constitution. This point has not heretofore been submitted to or passed upon by this Court.

As will be pointed out further, the Wisconsin Supreme Court, in its decision in the instant case, disclosed that on this issue in the case before them there was an even division among the six Justices who participated in the decision, one Justice not sitting.

The record shows that the Act was to "take effect on passage and publication, on September 26, 1935." (Ex. 6. R. 18) The record shows that there had been an accumulation of Appellant's so-called surplus from Wisconsin earnings going back at least to 1931; that preceding the date of enactment of the law this accumulated surplus amounted to $803,780.72, and that by December 31, 1935, following the enactment, it had increased to $2,227,493.03 (Ex. 7a. R. 34). It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26,

1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law. It is undisputed that the Wisconsin Department of Taxation included in the total "Wisconsin surplus" on which the challenged tax was calculated, all of that surplus accumulated over the years preceding the enactment of the law.

The question is, therefore, squarely presented whether it is possible within the principles of due process under the Federal Constitution, to sustain the Act in question as imposing a tax upon dividends declared and paid subsequent to the enactment of the law, but from income accumulated by Appellant over an indefinitely long period prior to the enactment.

The answer to this question depends upon the determination as to the basis of the tax, whether grounded upon the privilege granted by the state to the corporation of carrying on business in the state, or whether based solely upon the privilege of declaring and receiving dividends. In answering this question it is not enough to look at the simple transaction of declaring and receiving dividends, though that is the transaction described in the Act. If the law is to be sustained at all against foreign corporations and their non-resident stockholders it must be upon some broader basis than the transaction so simply stated. It becomes necessary, therefore, to look to whatever foundation has been shoved under the tax structure to support its constitutionality, however unstable and anomalous that support may be. The only grounds thus far suggested to sustain the tax against foreign corporations and their non-resident stockholders is the privilege granted by Wisconsin to such foreign corporation to transact business and derive income in the state. That privilege, this Court said in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, is the privilege to which the tax bears the requisite fiscal relationship. It is to be specifically noted that such statement by this Court was made before the Wisconsin Supreme Court had finally and authorita-

tively determined that the tax is a privilege tax imposed on the stockholder in contrast to an income tax against the corporation. *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221, 10 N. W. (2d) 142; *Wisconsin Gas & Electric Co. v. Department of Taxation*, 243 Wis. 216; 10 N. W. (2d) 140.

Looking, therefore, to the question of permissible retroactivity of the tax and assuming for the argument that the law is otherwise valid, we find the justification for the tax stated by the Wisconsin Supreme Court thus:

> "We adhere to our determination upon remand of the *Penney Case* that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend." (243 Wis. 198, 206; 10 N. W. 2d, 169, 172)

Though feeling itself compelled to accept the mandate of this Court as to Wisconsin's power to impose the tax in question, the Wisconsin Supreme Court nevertheless in its decision in the instant case pointed out that this Court had reduced the privilege of declaring and receiving dividends "to mere conditions or contingencies, on the happening of which the tax accrues." (243 Wis. 206) In considering the retroactive effect of the tax law regard must be had to the "jurisdictional fact", or "basis of Wisconsin's power to tax", rather than to the "mere conditions or contingencies" upon which the tax may accrue,—the more so since such "mere conditions or contingencies", being the declaration and receipt of the dividends, occurred entirely outside the state of Wisconsin.

If Wisconsin's power to impose a tax upon the non-resident stockholder of a foreign corporation is to be justified by the privilege granted by the state to that corporation to earn income within the state, then under the decisions of this Court as to the per-

missible retroactivity of new tax laws the thrust of the tax cannot reach income earned by the corporation prior to the date of enactment of the law. In *Welch v. Henry*, 305 U. S. 134; 83 L. Ed. 87, this Court affirmed the Wisconsin court in sustaining application of the Wisconsin income tax retroactively to "recent transactions", i.e., dividends received in a prior year. Against the the objection that the tax because retroactive was a denial of due process, this Court in that case (page 147), said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. * * * Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process."

Upon the issue of permissible retroactivity of the tax the Wisconsin court, in the instant case, was evenly divided, and the tax assessment against Appellant was accordingly affirmed. On behalf of the three Justices who would limit the retroactive operation of the law it was said:

> "(1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax, is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wis-

consin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent transactions'; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion." (P. 208)

Even the retroactivity which would have been permitted by the members of the Wisconsin court whose views are quoted above, would be condemned as arbitrary and lacking due process under the tests laid down by this Court. (See *Welch v. Henry, supra*) This for the reason that for the Wisconsin privilege dividend tax there was no precedent in Wisconsin law, nor, so far as we are aware, in the laws of any other state. At no time prior to the initiation of the particular legislative process could that tax have been anticipated.

Prior to 1935, while Appellant was exercising the privilege of doing business in Wisconsin and accumulating the surplus from which the dividends in question were later paid there was no intimation of a tax to be imposed *generally* upon residents and non-residents alike upon the *distribution* of Wisconsin income. There was indeed, overwhelming precedent in the decisions of the Wisconsin Supreme Court that such a tax could not constitutionally be imposed. (*Newport Co. v. Tax Comm.*, 219 Wis. 293; 261 N. W. 884; *State ex rel. Manitowoc Gas Co. v. Tax Comm.*, 161 Wis. 111; 152 N. W. 848)

Mr. Justice Roberts, in the *Penney case*, filed a dissenting opinion in which Mr. Chief Justice Hughes, Mr. Justice McReynolds and Mr. Justice Reed concurred. It was there said:

> "I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders." **(Pages 446–447)**

In *Connecticut General Life Insurance Company v. Johnson*, 303 U. S. 77, 79, 82 L. Ed. 673, 677, this Court said:

> "A corporation which is allowed to come into a state and there carry on its business may claim, as an individual may claim, the protection of the Fourteenth Amendment against a subsequent application to it of state law. *Hanover F. Ins. Co. v. Harding* (Hanover F. Ins. Co. v. Carr), 272 U. S. 494, 71 L. Ed. 372, 47 S. Ct. 179, 49 A. L. R. 713; compare *Kentucky Finance Corp. v. Paramount Auto Exch. Corp.*, 262 U. S. 544, 67 L. Ed. 1112, 43 S. Ct. 636."

For the privilege of doing business, granted by Wisconsin to Appellant for the years prior to enactment of the dividend tax, Appellant had met all conditions exacted by the state. The privilege had ripened into vested rights, since the income derived from Wisconsin business, completely discharged from all income taxes, or other charges or restrictions, had been reduced to capital, had been sent outside of Wisconsin, and had become an indistinguishable part of Appellant's funds held beyond the borders of Wisconsin. Such fruits of the privilege granted by Wisconsin were protected from further legislative encroachment. Appropriate to this situation is the following language quoted by this Court in *Coolidge v. Long*, 282 U. S. 582, 603; 75 L. Ed. 562, 570, taken from *Re Craig*, 97 Appellate Division, 289, affirmed 181 N. Y. 551; 74 N. E. 1116:

> "But when the privilege has ripened into a right it is too late to impose conditions of the character in question, and

when the right is conferred by a lawfully executed grant or contract it is property and not privilege, and as such is protected from legislative encroachment by constitutional guaranties."

We submit that, even were the Privilege Dividend tax otherwise valid, it must be held fatally retroactive and violative of due process insofar as it purports to reach income accumulated prior to the enactment of the law albeit distributed by a dividend declared and paid subsequent to the enactment.

III.

The formula under which the Wisconsin privilege dividend taxes are imposed on Appellant is a formula not authorized by the statute, and taxes imposed under such a formula deny due process of law under the Fourteenth Amendment.

This issue has not been before this Court hitherto in its consideration of the Wisconsin Privilege Dividend Tax. Briefly, the issue is whether the assessment made by the Wisconsin Department of Taxation on a formula not provided for by the Wisconsin Privilege Dividend Tax Act denies due process of law under the Fourteenth Amendment to the Federal Constitution.

The Wisconsin Privilege Dividend Tax Act (Sec. 4) provides that the proportion of each dividend allocated to Wisconsin shall be ascertained "in accordance with the provisions of Chapter 71." Chapter 71 is the general income tax chapter. The Wisconsin Privilege Dividend Tax Act adds that in the absence of proof to the contrary the "dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend."

The pertinent provisions of Chapter 71, being Sec. 71.02 (3) (d) Wis. Stats. are set forth in Appendix B page 54 hereof.

Chapter 71 (the general income tax chapter) provides that in the case of a corporation doing business within and without Wisconsin there shall first be deducted non-apportionable income and that the remaining, or apportionable income, shall be allocated to Wisconsin on the average of three ratios: The ratio of tangible property in Wisconsin to total tangible property, the ratio of sales in Wisconsin to total sales, and the ratio of cost of manufacturing in Wisconsin to total cost of manufacturing.

It is provided that if the use of any one ratio gives an unreasonable or inequitable final average ratio that ratio may be omitted.

This average ratio under the income tax computation is applied to the apportionable net income.

In the privilege dividend tax assessment involved in this appeal the above income tax fraction has been applied by the Wisconsin Department of Taxation to ascertain the portion of the book income each year derived from Wisconsin. (R. 10, 13, 14) That is all it is used for. It is dropped out of the computation from that point on. The Wisconsin Department of Taxation proceeded to accumulate such book income derived from Wisconsin from year to year. It called the accumulated amount Wisconsin income reflected in surplus.

When a dividend was paid the Department divided Wisconsin income reflected in surplus by total surplus and multiplied the total dividend paid by this fraction. The result obtained was the amount of the dividend attributed to Wisconsin, which was taxed at the regular dividend tax rate.

It will be seen how far distant this process is from ascertaining the amount of the dividend derived from Wisconsin under the provisions of Chapter 71, the Income Tax Chapter.

In the first place the income tax formula is used only to determine the proportion of book income in the current year derived from Wisconsin.

In the income tax calculation the income tax fraction is applied against taxable net income, not book net income.

Taxable net income is a very different figure from book net income. For one thing, reserves are deducted in arriving at book net income, but not in arriving at taxable net income.

Wisconsin earnings reflected in surplus is neither an income tax figure nor a book figure. It is a figure resulting wholly from a computation made by the Wisconsin Department. It is utterly unknown to Chapter 71, the Income Tax Chapter; it is utterly unknown to the Wisconsin Privilege Dividend Tax Act.

Total surplus is a book figure which is not used in the income tax computation.

Wisconsin earnings reflected in surplus divided by total surplus is a fraction utterly unknown to the Income Tax Chapter and to the Wisconsin Privilege Dividend Tax Act.

For detailed computation of tax see Exhibit 7a, R. 33–36.

It is significant, we submit, that the Wisconsin Privilege Dividend Tax Act (Sec. 4) provides that if a corporation had a loss for the year prior to the payment of the dividend the Department of Taxation "shall upon application" determine the portion of the dividend "paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." Obviously the application referred to is that of a taxpayer. But there is no such provision for determining the portion of the dividend paid out of surplus except in the case of a loss and then only in the case of an application by the taxpayer. In the case of a corporation which did not have a loss the ascertainment must be made according to Chapter 71, the Income Tax Chapter. The record shows in this case that there was no loss by the Appellant in any of the years involved. (Exhibit 7a, R. 34, 36)

There is no alternative formula provided for in the Income Tax Chapter. The only modification of the income tax formula that may be made is, as we have seen, that one of the three ratios may be dropped out. But there is no provision for substituting a new ratio in place of the one dropped out, much less for substituting an entirely new formula.

Neither is there an alternative formula provided for in the Wisconsin Privilege Dividend Tax statute.

It is obvious that the formula adopted by the Wisconsin Department of Taxation is wholly unknown to the income tax statute and is wholly unknown to the Wisconsin Privilege Dividend Tax statute.

The above explanation and the testimony of Herbert D. Kuentz, Chief Accountant of the Department (R. 9–14 and R. 16–17) show not only the extremely complicated character of the Wisconsin Department of Taxation's formula on which Appellant's taxes have been assessed, but how many assumptions have been made in carrying out that formula and, above all, how radically different the Wisconsin Department's formula is from the simple income tax formula provided in the statute.

We submit, therefore, that the Wisconsin Department of Taxation has ascertained the amount of the dividends taxed in this case by a process wholly unauthorized either by the Wisconsin privilege dividend tax act or the Wisconsin income tax law.

In the case of *Davis v. Wallace,* 257 U. S. 478, 485; 66 L. Ed. 325, 329, the United States Supreme Court said that where the formula provided for by the statute could not be constitutionally applied the taxing officers were not "at liberty to assess it on another and different basis which the statute shows was not to be applied to corporations in a class to which these railroad companies belong." It added, "Of course we cannot so hold."

Likewise, in *Oklahoma v. Wells Fargo Company,* 223 U. S. 298; 56 L. Ed. 445, a case in which the statutory formula could

not constitutionally be applied, Mr. Justice Holmes, writing the opinion, declared that "Neither the court below nor this Court can reshape the statute simply because it embraces elements that it might have reached had it been drawn with a different measure and intent."

In *Commonwealth v. P. Lorillard Co.*, 105 S. E. 683, 685, the Supreme Court of Appeals of Virginia cited with approval the case of *Oklahoma v. Wells Fargo Co.*, *supra*, and stated that the taxing power:

> "is exerted through the legislature, and an executive officer who seeks to enforce a tax must always be able to put his finger upon the statute which confers such authority. Taxes can only be assessed, levied and collected in the manner prescribed by express statutory authority. Tax assessors have no power to make an assessment except in the manner prescribed by law, and if the statute prescribes a method of assessment which is invalid, the assessor has no power or authority to adopt a method of his own which would have been legal if it had been prescribed by the legislature."

It went on to say "The statute conferred no such authority on them (the taxing officers) and they had no such power", namely, no power to "devise a scheme of their own by which to determine how much of the total income of the defendant in error was derived from business done in this state." It held that "the Legislature alone could exercise this power, and, having failed to do so, no such apportionment can be made. * * *"

In *Dravo Contracting Company v. James*, 114 Fed. (2d), 242 (C. C. A. Fourth Cir.), there was involved a West Virginia gross income tax applying in that case to a contractor constructing locks and dams in West Virginia under a contract with the Federal Government. The court said that it agreed with the taxpayer

> "that the court was without power to apportion its (the taxpayer's) income on the basis of the cost of the activities

involved in earning the income within and without the state. No such basis of apportionment is prescribed by statute; and, in the absence of statute, the court is without power to adopt it, as this is a legislative function involved in the imposition of the tax, and therefore not one which courts may exercise."

This Court denied certiorari in this case. (312 U. S. 678; rehearing denied 312 U. S. 714)

See also:

Fisher v. Standard Oil Co., 12 Fed. 2d, 744, 747.
Ford Motor Co. v. State, 258 N. W. 596, 603. (N. Dak.)

It is true that in the case at bar the Wisconsin Supreme Court has approved the formula applied in computing appellant's taxes. But the Wisconsin Supreme Court has no more power to evolve a formula not authorized by the statute than the Wisconsin Department of Taxation has. (*Oklahoma v. Wells Fargo Co.*, also *Dravo Contracting Co. v. James*, quoted above)

This Court has emphatically held that a formula which allocates an arbitrary or excessive portion of capital stock value or of net income to the taxing state is a denial of due process of law. This was held as to a state income tax in *Hans Rees' Sons v. N. Carolina*, 283, U. S. 123; 75 L. Ed. 879.

As a formula allocating an excessive amount of income or of capital stock value is a denial of due process of law, a fortiori the allocation of an amount of dividend derived from Wisconsin under a formula wholly unauthorized by law is a denial of due process. The very essence of due process is taxation according to constituted authority granted by state and a tax levied on a basis devised by taxing officers without any authority by statute whatever would seem necessarily to be a denial of due process of law.

Conclusion

We submit, therefore, in conclusion that testing the Wisconsin Privilege Dividend Tax as applied to dividends paid by the International Harvester Company, not by the name or label which the Wisconsin Supreme Court had given the tax, but by its actual operation and incidence, the tax can no longer be considered an income tax either on the corporation or on the stockholder.

The tax so far as the corporation is concerned, is not on income received by it. The Wisconsin Supreme Court has held that the income tax can only be on income received. The tax may not be deducted by the corporation as a business expense on its Wisconsin income tax return. The tax must be withheld from the dividends, both common and preferred dividends. The burden of the tax is placed directly and unmistakably on the stockholder.

The tax is not computed on the income tax formula.

The tax therefore in the situation presented to this Court bears no resemblance to an income tax on the corporation.

The tax would not be constitutional as an income tax on non-resident stockholders.

The privileges of declaring and receiving dividends are not exercised in Wisconsin, and therefore a tax laid on the exercise of those privileges is a denial of due process of law.

Even on the theory that the tax is, on income derived from Wisconsin, it would be invalid as applied to the distribution of income derived from Wisconsin prior to the enactment of the Wisconsin Privilege Dividend Tax Act.

Finally, the imposition of the tax on the basis of a formula not authorized by this statute but devised by the Wisconsin Department of Taxation to meet the exigencies of a situation where the dividends are paid out of surplus, is a denial of due process of law.

We do not present the following consideration as an argument on the constitutionality of the tax, as applied to the Appellant. But we submit that it is pertinent and proper in order to show what is involved in this appeal.

There is involved in the appeal more than the taxes paid by the Appellant in the period covered by this appeal. These taxes were paid before the decision of this Court in the *Penney case*, and the tax was not withheld from the dividends. Since then, as we have seen, the Wisconsin Supreme Court has held that the tax must be withheld from the dividends and may not be absorbed as a business expense by the corporation and deducted on its Wisconsin income tax return. There is also involved on this appeal, therefore, the question of withholding the tax in the future.

The tax in 1937, for example, on a quarterly common stock dividend in 1937 of $.625 per share would have been only $.01625 on twenty shares. (Namely, 2.5% tax on 5.8% of $12.50. R. 21, 33.) On ten shares it would have been only $.008125. On ten shares of preferred stock it would have been $.02503. There were 32,000 stockholders. (R. 36) It is obvious that this calculation would have to be made four times a year for each quarterly dividend of each stockholder. If each common stockholder were also a preferred stockholder, then the calculation would have to be made four times a year for the common stock dividends and four times a year for the preferred stock dividends, for each stockholder, or in other words, 256,000 calculations a year. This is the maximum number of calculations that would be required. To the extent that some of the stockholders held only one class of stock, the number of calculations would be proportionately decreased. For example, if 16,000 stockholders owned only common stock, and 16,000 stockholders owned only preferred stock, there would be 128,000 calculations annually. This would be the minimum number of calculations involved. It is surely inevitable that

a stockholder in Maine or California who received a dividend check with a deduction of $.01625 for the Wisconsin privilege dividend tax would wonder why he should be assessed such an amount for a tax in Wisconsin. The calculation of this tax a minimum number of 126,000 times a year would not only be costly and burdensome, but the annoyance and irritation caused its stockholders from Maine to California and in foreign countries, would be a legitimate matter of concern to any corporation desirous of retaining the good will of its stockholders.

Moreover, if this tax should be held a valid exercise of the taxing power of Wisconsin, and thereupon as many as twenty states should adopt a similar tax, it will readily be seen that the number of calculations required of this Appellant would be a minimum of 2,560,000 a year, and the danger of loss of stockholder good will that much intensified.

The law we submit has become a nuisance tax.

Respectfully submitted,

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APPENDIX "A"

The pertinent provisions of the Wisconsin Privilege Dividend Tax Act, being Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937; Published and effective September 26, 1935:

"Section 3. PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to 2½ per cent of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1939. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid

out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

* * *

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

* * *

(10) Except as they are inconsistent with this section, the provisions of paragraph (b) of subsection (3) of section 71.06, sections 71.10 to 71.17, inclusive, subsection (3) of section 71.18, sections 71.36 and 71.37 of the statutes shall apply to the tax imposed by this section, but the discount provisions of paragraph (c) of subsection (3) of section 71.10 shall not apply."

APPENDIX "B"

Pertinent provisions of Wisconsin Income Tax Chapter, Section 71.02 (3) (d), Wisconsin Statutes:

"(d) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income apportionable to Wisconsin may be determined by an allocation and separate accounting thereof, when, in the judgment of the department of taxation, that method will reasonably reflect the income properly assignable to this state, but otherwise in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.03 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following three ratios:

1. The ratio of the tangible property, real, personal, and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be

considered tangible property nor included in the apportionment.

2. In the case of persons engaged in manufacturing or in any form of collecting, assembling, or processing goods and materials within this state, the ratio of the total cost of manufacturing, collecting, assembling, or processing within this state to the total cost of manufacturing, or assembling, or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing within this state and everywhere,' as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justifies a different treatment, this term shall be generally interpreted to include as elements of cost within this state the following:

a. The total cost of all goods, materials, and supplies used in manufacturing, assembling, or processing within this state regardless of where purchased.

b. The total wages and salaries paid or incurred during the income year in this state in such manufacturing, assembling, or processing activities.

c. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling, or processing activities within this state.

3. In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies, or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year.

4. Where, in the case of any person engaged in business within and without the state of Wisconsin and entitled to an apportionment of his income as herein provided, it shall be shown, to the satisfaction of the department of taxation, that the use of any one of the three ratios above provided for gives an unreasonable or inequitable final average ratio

because of the fact that such person does not employ, to any appreciable extent in his trade or business in producing the income taxed, the factors made use of in obtaining such ratio, this ratio may, with the approval of the department of taxation, be omitted in obtaining the final average ratio which is to be applied to the remaining net income."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 620.

INTERNATIONAL HARVESTER COMPANY, *Appellant*,

v.

WISCONSIN DEPARTMENT OF TAXATION, *Appellee*.

On Appeal from the Supreme Court of Wisconsin.

APPELLANT'S REPLY BRIEF.

THE CONFLICT BETWEEN THIS COURT AND THE WISCONSIN SUPREME COURT IN THE CONSTRUCTION OF THE CHALLENGED TAX IS VITAL AND UNMISTAKABLE.

In an effort to avoid the issue now for the first time squarely presented in this Court Appellee boldly asserts that between the 1940 decision of this Court in *Wisconsin v. J. C. Penney Co.* (1940), 311 U. S. 435; 82 L. Ed. 267, and the recent decisions of the Wisconsin Supreme Court

in *Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221, *Wisconsin Gas & Electric Co.* v. *Tax Commission*, 243 Wis. 216, and in the instant case, no conflict exists in respect to the *construction* of the Wisconsin Privilege Dividend Tax Act. Appellee, to support this assertion, even quotes the opinion of the Wisconsin Supreme Court in the instant case. The language so quoted declares that "*we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction.*" However, the Wisconsin court in the very same paragraph in which appears this disclaimer of any conflict *as to jurisdiction to tax*, reiterates its construction of the law, saying: "We adhere to our determination upon remand of the *Penney case*, *supra*, that this is a privilege dividend tax * * *." In the companion case decided on the same day, *Wisconsin Gas & Electric Co.* v. *Tax Commission*, *supra*, the Wisconsin court categorically states (p. 220):

> "We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney case*."

That this Court, contrariwise, had previously sustained the law upon the concept that it was "an additional tax on corporate earnings within Wisconsin", "a supplementary tax on the Wisconsin earnings of such corporations", and was supported by the "substantial privilege of carrying on business in Wisconsin" which had been granted to the corporation, is not open to argument. We had supposed that much was clear, but took precaution to set forth in a footnote at page 15 of Appellant's Brief excerpts from the minority opinion of this Court in the *J. C. Penney case* and

from the lower federal courts, showing that this was the uniform acceptance of the majority opinion in the *Penney case*. Indeed, it seems perfectly clear that only as a supplemental income tax against the corporation measured by the earnings which the corporation had derived from property and business in Wisconsin and paid out in dividends, was the law susceptible of being sustained. This Court, in the *Penney case*, to sustain the law, said (p. 444-445):

> "The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and *transactions within a state for which the tax is an exaction.*" (Emphasis ours.)

Moreover, the court in that case, distinguishing *Connecticut General Life Insurance Co.* v. *Johnson*, 303 U. S. 77; 82 L. Ed. 672, said (p. 445):

> "Nor does *Connecticut General L. Ins. Co.* v. *Johnson, supra* (303 U. S. 77, 82 L. ed. 673, 58 S. Ct. 436), present a barrier against what Wisconsin has done. Its presuppositions recognize the scope of the state taxing power we have outlined, 303 U. S. 77, 80, 82, 82 L. ed. 673, 677, 678, 58 S. Ct. 436. In the precise circumstances presented by the record it was found that the tax neither in its measure nor in its incidence was related to California transactions. Here, on the contrary, the *incidence of the tax* as well as its measure is tied to the earnings which the State of Wisconsin has made possible, * * *." (Emphasis ours.)

Thus it clearly appears from the decision of this Court in the *Penney case* that there still prevails the rule that a transaction tax may be exacted only for transactions within the state, and that the measure and incidence of the tax must be related to transactions which transpire within the taxing state. In view of these prerequisites, a supple-

mentary income tax, measured by Wisconsin income and having its incidence upon the corporation to which the state has granted the privilege of doing business within its borders, would fit into the permissible scope of taxing power. Not so, a tax upon the right of a foreign corporation to declare dividends, nor upon the right of a non-resident stockholder to receive dividends, since both of such rights are enjoyed solely under the laws of a sister state and neither was exercised within the limits of Wisconsin.

Much of the uncertainty and confusion in Appellee's position, as evidenced by its brief here, would have been avoided by a recognition of a few fundamental concepts. At least two of those fundamental concepts are stated in *Home Savings Bank* v. *Des Moines*, 205 U. S., 503; 51 L. Ed., 901. There it was declared (p. 910):

> "It is said that where a tax is levied upon a corporation, measured by the value of the shares in it, it is equivalent in its effect to a tax (clearly valid) upon the shareholders in respect of their shares, because, being paid by the bank, the burden falls eventually upon the shareholders in proportion to their holdings. It was upon this view that the lower court rested its opinion. But the two kinds of taxes are not equivalent in law, because the state has the power to levy one, and has not the power to levy the other. The question here is one of power, and not economics. If the state has not the power to levy this tax, we will not inquire whether another tax, which it might lawfully impose, would have the same ultimate incidence. Precisely the same argument was made and rejected in Owensboro Nat. Bank v. Owensboro, 173 U. S. 664; 43 L. Ed. 850; 19 Sup. Ct. Rep. 537."

And from *Owensboro Nat. Bank* v. *Owensboro*, cited in the above quotation, the court quoted:

> "'The argument that public policy exacts that where there is an equality in amount between an unlawful tax and a lawful one, the unlawful tax should be held valid, does not strike us as worthy of serious consideration.'"

Statement of the fundamental distinction between the taxation of a *shareholder* of a corporation and the taxation of the *corporation*, a second concept necessary to be recognized here, was also called for in *Home Savings Bank* v. *Des Moines, supra*, since there was involved a state tax directing that shares of stock of a state bank should be assessed to the bank, rather than to individual stockholders, without permitting in the valuation a deduction on account of bonds of the United States owned by the bank. The court said (p. 910):

> "But the distinction between a tax upon shareholders and one on the corporate property, although established over dissent, has come to be inextricably mingled with all taxing systems, and cannot be disregarded without bringing them into confusion which would be little short of chaos."

As already noted, Appellee rests its case upon the concept that the tax is against the corporation and is supported by privileges granted to the corporation by the state of Wisconsin. However, as we have pointed out at pages 19 to 26 of Appellant's Brief, the Wisconsin Supreme Court, exercising its acknowledged function to construe the state statute, has unequivocally declared that the burden of the tax is upon the stockholder. This the Wisconsin court held specifically in the case brought by the preferred stockholder against his corporation for recovery of the amount of the Wisconsin privilege dividend tax withheld by the corporation from his dividend. (*Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221.) In contrast with its present stand, Appellee heretofore, in its Brief Opposing Motion for Rehearing filed in the Wisconsin Supreme Court in the instant case, at page 8 thereof, declared:

> "It is immutably established by the *Wisconsin Gas and Electric case* (June 16, 1943) that the burden of the privilege dividend tax is upon the stockholder. Lest anyone question that the court actually so held,

need we do more than to set out the following statement in that case:

'We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney Case*. It follows that appellants' contentions must fail.' "

The Wisconsin Supreme Court, upon remand of the *J. C. Penney case*, pointed out (238 Wis. 69, 73):

"Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not a tax on the privilege of declaring and receiving a dividend as we hold it to be, then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof."

The fact that the subject of the tax is a *declared dividend* demonstrates its character and fixes its incidence. Dividends are declared from earnings *after* corporate taxes and charges. The tax is not deducted from the amount otherwise declarable as a dividend. It is imposed upon and deducted from the full amount declared.

Upon the declaration of the dividend the *right* of the stockholder to *receive* it attaches. That right, being a debt owing the stockholder by the corporation, is a distinct legal right attaching to the ownership of the stock. (*Beidler* v. *South Carolina Tax Commission*, 282 U. S. 1, 9; 75 L. Ed. 131, 134.) Since the tax is measured by the full amount of the dividend declared and belonging to the stockholder, and is specifically required by the law to be deducted from the amount so belonging to the stockholder, it most certainly

is imposed upon and taken from the stockholder. (*Colorado Nat. Bank* v. *Bedford*, 310 U. S. 41, 52.)

It is argued by Appellee that because the corporation is made liable for the tax, and no personal liability is sought to be imposed upon the stockholder therefor, the law imposes the tax upon the corporation. It is true that in a purely mechanical sense the corporation is required to pay the tax, but the corporation is required by the law to withhold the amount of tax from the dividend declared, and if it does as the law specifies the corporation is not a whit poorer because of the tax. The corporation is merely a collector of the tax for the state, and is directed to reimburse itself as it has the means to do. While it is true that the corporation pays and is made liable to the state for the tax, nevertheless such payment is not in satisfaction of its own liability, but as a withholding agent of the shareholder. Of a similar situation where the Federal Revenue Act of 1864 required corporations to withhold and pay taxes against stockholders in respect to dividends, this Court, in *U. S.* v. *Baltimore & Ohio R. R. Co.*, 17 Wall. 322; 21 L. Ed. 597, 599, said:

> "In the cases we are considering the Corporation parts not with a farthing of its own property. Whatever sum it pays to the Government is the property of another. Whether the tax is five per cent on the dividend or interest, or whether it be fifty per cent, the Corporation is neither richer nor poorer. Whatever it thus pays to the Government, it by law withholds from the creditor. If no tax exists, it pays seven per cent, or whatever be its rate of interest, to its creditor in one unbroken sum. If there be a tax it pays exactly the same sum to its creditor, less five per cent thereof, and this five per cent it pays to the Government. The receivers may be two, or the receiver may be one, but the payer pays the same amount in either event. It is no pecuniary burden upon the Corporation, and no taxation of the Corporation. The burden falls on the creditor. He is the party taxed."

It is even said by Appellee that the burden of the tax is the same whether the corporation withholds the amount of tax from the stockholder's dividend, or whether the corporation fails to withhold and itself absorbs the tax, charging it to surplus. Clearly this is not true as a practical matter even as to the common stockholder, and as to a preferred stockholder entitled to a specified rate of dividend before anything is paid on the common stock there is an obvious and vital difference. The difference is so plain that it needs no elaboration, albeit wholly overlooked by Appellee.

Indeed, the vital difference between a tax against the corporation, whether called a supplemental income tax or by any other name, and a tax against the stockholder, while no less real as between the common stockholder and his corporation, is more apparent in the case of the preferred stockholder entitled cumulatively to a specified rate of dividend. Moreover, the point as to where the burden of the tax is laid, whether imposed on the corporation or on the stockholder, is not a matter of indifference, not "purely a matter between" corporation and stockholder, as Appellee argues. It is a vital matter, involving of necessity "the operating incidence of a challenged tax", the "practical operation" thereof, which are crucial tests in determining whether the tax is constitutional.

We believe we have shown that the tax can no longer be considered as a tax on the corporation's income, nor on the stockholders' income, nor on the privilege of declaring and receiving dividends.

Summarizing briefly, the tax bears no resemblance any longer to a corporate income tax. It is not assessed on income received and the Wisconsin Supreme Court has held that income tax can only be assessed on income received. The corporation paying the dividend is required to withhold the tax from the dividend, and may not absorb the tax as a business expense and deduct it on its Wisconsin income tax return.

The Wisconsin Court has held the tax cannot be sustained as an income tax on the income of nonresident stockholders.

The privilege of declaring dividends is not exercised in Wisconsin, and the privilege of receiving dividends is not exercised in Wisconsin by more than 98 per cent of the stockholders.

Appellee is therefore driven to the position that the dividends can be taxed on the theory that the fund from which they are paid was originally partly derived from Wisconsin.

On this theory a dividend payable from surplus may be declared by a corporation five or ten years after earnings were derived from Wisconsin, and yet the right is asserted to tax the dividend because five or ten years previously part of the fund from which the dividends were paid was derived from Wisconsin.

The Analogy of the Inheritance and Estate Tax Cases is Unsound.

Appellee argues, however, that inheritance and estate taxes have been upheld although the taxing jurisdiction did not grant the privilege to make the transfer, and although the transfer was not effected in the taxing jurisdiction. It is argued that it is the right and not the privilege which is taxed.

But in the case of Appellant's dividends the stockholder in Indiana or Massachusetts who receives a dividend exercises no right in Wisconsin, nor does the corporation exercise any right in Wisconsin with respect to that stockholder.

Appellee also argues that inheritance taxes have also been sustained "where no physical act effectuating the transfer took place within the jurisdiction of the state".

But in such cases of inheritance taxes, either the decedent was a resident of the taxing state or had property having a taxable situs in the taxing state, or the corporation was domiciled in the taxing state. Here the dividend is not received within the state by the nonresident stockholder and the Appellant is not domiciled in Wisconsin.

The question of whether a state could impose an inheritance tax on the value of stock held by a nonresident stockholder simply because the corporation did business in the taxing state and held property there was definitely settled in the negative by this Court in *Rhode Island Hospital Trust Co.* v. *Doughton*, 270 U. S. 69. There South Carolina imposed an inheritance tax on the transfer from a Rhode Island decedent on stock in a New Jersey Corporation. The claim was made because two-thirds of the property of the New Jersey Corporation was in North Carolina, that North Carolina might treat the shares of stock as having situs in North Carolina to the extent of the ratio in value of its property in North Carolina to all of its property. The theory of the State was that the stockholder was the owner of part of the property of the corporation, and that the state which had jurisdiction of any of the corporate property had *pro tanto* jurisdiction to levy inheritance tax on the value of his share of the stock.

This Court refused to concur in this view because, as it said: "The owner of the shares of stock in a company is not the owner of the corporation's property." The Court there quoted at some length from *Van Allen* v. *Assessors*, 3 Wall. 573, 583; 18 L. Ed. 229, 234, as follows:

> "'But, in addition to this view, the tax on the shares is not a tax on the capital of the bank. The corporation is the legal owner of all the property of the bank, real and personal; and within the powers conferred upon it by the charter, and for the purposes for which it was created, can deal with the corporate property as absolutely as a private individual can deal with his own. This is familiar law, and will be found in every work that may be opened on the subject of corporations.
>
> . . . .
>
> The interest of the shareholder entitles him to participate in the net profits earned by the bank in the employment of its capital, during the existence of its charter, in proportion to the number of his shares; and upon its dissolution or termination, to his proportion of the property that may remain of the corporation

after the payment of its debts. This is a distinct independent interest or property, held by the shareholder like any other property that may belong to him.'"

After some examination of state decisions the Court continued:

"But whatever the view of the other courts, that of this court is clear, the stockholder does not own the corporate property. Jurisdiction for tax purposes over his shares can not, therefore, be made to rest on the situs of part of the corporate property within the taxing state."

And again:

"Our conclusion is in accord with the great majority of cases in the state courts where this exact question has arisen. (Citing cases) Tyler v. Dane County (D. C.), 289 Fed. 843, contains a full and satisfactory discussion of the subject in a Wisconsin case which has been followed by the supreme court of Wisconsin in Shepard's Estate, 184 Wis. 88, 197 N. W. 344."

In *Estate of Shepard*, 184 Wis. 88, there was involved the assertion of a Wisconsin inheritance tax on the transfer of stock of a foreign corporation owned by a non-resident decedent, the basis of the claim being that the corporation owned property in Wisconsin. The Wisconsin Supreme Court reasoned thus:

"But if the decedent was not a resident of the state at the time of his death and the person receiving it is a non-resident and the property to be transferred is without the state, then there is no right to tax because the subject matter is beyond the jurisdiction of the court. Either the property transferred must be within th state or the decedent must have died a resident thereof or some recourse to the courts or laws of our state must be necessary to secure the transfer in order to confer jurisdiction to impose a valid tax. Sec. 72.01, Stats. 1923."

And again at page 94:

> "It requires no careful scrutiny of these provisions declaring when a tax shall be imposed to disclose that they do not include the imposition of a tax upon the transfer of stock held and possessed by a nonresident decedent in a foreign corporation having property and being licensed to do business in this state, unless the property of the corporation is held to be the property of the stockholders. But this court has never so held. • • • The supreme court of the United States has never so held. It has declared that the property of the shareholders in their respective shares is distinct from the corporate property, franchises, and capital stock. *Hawley* v. *Malden*, 232 U. S. 1, 34 Sup. Ct. 201; *Eisner* v. *Macomber*, 252 U. S. 189, 40 Sup. Ct. 189. In *Des Moines Nat. Bank* v. *Fairweather*, 263 U. S. 103, 44 Sup. Ct. 23, the court had occasion to point out the difference between corporate assets of the corporation and shares. It held the former belonged to the corporation as an artificial entity and the latter to the stockholders."

See also *Eisner* v. *Macomber*, 252 U. S. 189, 213; 64 L. Ed. 521, 531.

The case of *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, is a definite holding in denial of Appellee's claim now that because part of the stockholder's dividend was derived from surplus which was originally derived from Wisconsin, Wisconsin can tax a portion of that dividend. In *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, a portion of the value of the shares of the corporation was originally derived from North Carolina, and yet North Carolina was not permitted to impose an inheritance tax on a portion of the value of those shares.

We submit that *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, is conclusive authority against the final contention of Appellee's Brief that the tax may be justified on the ground that the fund from which the dividend was paid was originally partly derived from Wisconsin.

The Legislature Has Not Approved the Interpretations of the Courts by Extending the Life of the Tax.

Appellee devotes many pages of its Brief in support of the proposition that the Wisconsin legislature has re-enacted the Wisconsin Privilege Division Tax several times, and that by such re-enactment has embodied in the law the interpretations made by this Court and by the Wisconsin Supreme Court.

We are not clear that we understand what this contention means. We have contended in Appellant's Brief, and reassert here, that the determinations made by the Wisconsin Supreme Court as to the actual operation and incidence of the tax are controlling. But this is far from the proposition presented by the Appellee, if we understand it. To assert that the Wisconsin legislature accepted and incorporated into law by re-enactment all the interpretations made by this Court and the Wisconsin Supreme Court is to strain to the breaking point the rule that re-enactment of a statute ratifies prior administrative rulings and Court decisions.

We would have to ask what interpretation Appellee has in mind. The tax has been designated as a supplementary tax on corporate income. It has been designated as an excise tax. It has been characterized as a tax on the corporation, and it has been characterized as a tax on the stockholder. Appellee contends that the Wisconsin Court did not hold that the tax was one on the stockholder, but their very contention shows that the interpretations of that court were not free from doubt.

If Appellee means that the Wisconsin legislature has approved the formula employed in this case, we must seriously dissent on several grounds.

In the first place the rule that re-enactment of a statute incorporates in the statute the regulations of an administrative body, or the construction given a statute by the Court, applies only where the administrative rulings or

regulations, or judicial constructions have been well and long established, and where the language is dubious or ambiguous.

Louisville & Nashville R. R. v. *United States*, 282 U. S. 740, 751.

The decision in this case was only handed down on June 16, 1943.

The statute extending the term of the Wisconsin Privilege Dividend Tax for another two years was enacted effective June 29, 1943.

Moreover, Appellant filed a petition for rehearing, which was denied on September 14, 1943.

The decision approving the surplus formula, can, we submit, in no sense whatever be said to have been approved by the Wisconsin legislature by extending the life of the tax by a law effective on June 29, 1943. There is no language whatever in the Wisconsin Privilege Dividend Tax Law providing that a formula dividing Wisconsin surplus by total surplus can be used.

The formula set out in the statute is the income tax formula and that is the only formula.

There is no place for construction of language therefore, and no basis for the application of the rule that reenactment of a statute in the case of dubious or ambiguous language ratifies administrative action or court construction of that language.

The sole question is whether under the Wisconsin Privilege Dividend Tax the Wisconsin Department had authority to adopt a new formula unauthorized by the statute. We have submitted under definite decisions of this Court that it had no such authority. Accordingly we submit that the tax assessed on an unauthorized formula is a denial of the due process of law.

AS TO RETROACTIVE OPERATION OF THE TAX.

In asserting that the challenged tax does not operate retroactively Appellant looks solely to the transaction of declaring and receiving dividends, which, of course, is made the occasion for imposing the tax. Nevertheless Appellant, in support of the law generally, argues that while the series of events from conduct of the business resulting in corporate earnings to the final declaration and receipt of the dividend is "one integrated and indivisible transaction", yet it is by reason of the fact that the state has given benefits in respect to the earning of the income and preservation thereof that the state has jurisdiction to tax. Even if this were assumed, for purposes of argument, the first and fundamental privilege, without which there could be no tax, is the license granted by a state to the corporation to do business. It was this "substantial privilege of carrying on business in Wisconsin" which this Court pointed to as supporting the tax, when looked upon as a supplemental income tax against the corporation.

If, as Appellee argues, the privilege of earning income in this state is the *foundation of the tax* clearly the tax could in any event reach only that income earned from the privilege after the enactment of the dividend tax law. Due process requires that a taxpayer should have the privilege of determining for itself whether to transact business within the state upon terms exacted. That, as to conditions imposed by the Privilege Dividend Tax Law the taxpayer could do only *after the enactment of that law.* (See *Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87.)

Clearly cases cited by Appellee on this point, but where there was a single basis and occasion for imposing the tax, as, for example, an income tax on the realization of income or capital gains, lend no support in the situation here presented.

THE FISCAL EFFECT OF HOLDING THE TAX INVALID SHOULD BE GIVEN NO WEIGHT ON THIS APPEAL.

Going outside of the record in the instant case, it is pointed out at page 19 of Appellee's brief that from the date of enactment through the first three months of the present year there has been collected by way of privilege dividend tax upwards of $16,000,000.00. It may be answered that whatever the outcome of this suit, much of the amount thus collected by the state is not open to refund, any rights in that respect having been long since barred. It may be pointed out too that a very substantial amount collected is in respect to Wisconsin corporations and its stockholders, and the validity of the law in respect to them is not here in question. But in any event there is not here involved the "delicate process of fiscal policy-making" with which this Court in the *Penney case* hesitated to inject itself "in a merely negative way." Here we are dealing with a legislative act which was the hasty result of a political compromise, and represents an ingenious attempt to excise a portion of dividends paid to the great number of non-resident stockholders of foreign corporations. Of only temporary character and at a low rate at its inception, the tax has been repeatedly given an extended life and the rate increased, as amply shown by the records in this Court. From its inception this tax has been productive of doubt and litigation, a source of irritation to the stockholders, and a constant cause of uncertainty and difficulty for those called upon to administer it.

In *J. C. Penney Co.* v. *Tax Commission*, 233 Wis. 286, 297, the Wisconsin Supreme Court stated that it had been strongly urged to affirm the judgment in that case "because the state treasury is dependent upon the maintenance of the right of the state to tax dividends of foreign corporations to the extent that such dividends are derived from earnings within the state." It answered:

"The matter of financial exigencies of the state, however, afford no justification for the ignoring of a rule of law laid down by the United States supreme court. The state must find its revenues within the field within which its taxing power may be exerted as prescribed by the constitution and laws of the United States."

THE QUESTION OF THE FORMULA.

Appellee's Brief on page 59 states that scattered through the Brief of Appellant, International Harvester Company, "there are references to details in the computation of the taxes here involved and, if not actually then inferentially, complaining in respect thereto. To the extent any such arguments relate to the details of computation they are foreclosed by and contrary to the stipulation entered into by counsel for appellant" (Case No. 620, R. 30-31) and should be disregarded."

We presume that Appellee refers particularly to the argument beginning on the top of page 45 of Appellant's brief, where it is argued that the formula used by the Wisconsin Department of Taxation and approved by the Wisconsin Supreme Court in this case is radically different from the formula prescribed by the statute.

We respectfully submit that none of the argument in regard to the validity of the formula is foreclosed by the stipulation, Exhibit 7-A (R. 30-31). That stipulation we submit is clear and unmistakable in its meaning. It says simply that the appellant does not contest the computation of the tax on the assumptions made by the Wisconsin Department of Taxation, but it distinctly reserves the right to contest the validity of those assumptions. The second paragraph of the stipulation states that International Harvester Company reserved the right to contest the validity of the Privilege Dividend Tax Law "as applied on the presumption that the International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and

business reflected in its surplus, bore to its total surplus, or as in any manner applied to the petitioner" (R. 31).

Frankly, we cannot understand how there can be any misunderstanding as to the meaning of the above language. It means, we submit, that the computations are not in contest on the basis of the assumptions made, but that the assumptions are most definitely in contest.

The Wisconsin Privilege Dividend Tax Law provides that the proportion of the dividend attributable to Wisconsin shall be ascertained according to the provisions of Chapter 71. Chapter 71 is the income tax chapter. It provides that the proportion of income attributable to Wisconsin, in the case of a taxpayer doing business within and without the state of Wisconsin, shall be ascertained by applying to the total apportionable net income, the average of three ratios:

> The ratio of tangible property in Wisconsin to total tangible property;
>
> The ratio of sales in Wisconsin to total sales; and
>
> The ratio of cost of manufacturing in Wisconsin to total cost of manufacturing.

The Wisconsin Supreme Court held, in the *Penney case* on remand, that the above formula could not be used when a dividend was paid out of surplus and not out of current earnings, and stated that it would be necessary to find what proportion of the surplus was derived from Wisconsin and apply that proportion to the dividends.

The Wisconsin Department accordingly proceeded to ascertain what proportion of the surplus was derived from Wisconsin. To do that it took the income tax fraction each year and applied it to book net income, and called the result book income apportioned to Wisconsin. It accumulated book net income derived from Wisconsin from year to year in an amount which it called Wisconsin income reflected in surplus or Wisconsin surplus, and

divided that amount by total surplus and applied the resulting fraction to the dividend.

It may be conceded that the Wisconsin Department intelligently and sincerely endeavored to comply with the decision in the *Penney case* on remand, but the more it endeavored to comply with the *Penney* decision, the more it was changing the statute, in short, legislating.

We submit that the Wisconsin Department had an impossible task. It was told by the Wisconsin Supreme Court that where a dividend is paid out of surplus it could not apply the formula provided by the Wisconsin Privilege Dividend tax, the income tax formula, the only one provided by the statute. It was told that it must determine what portion of the surplus of the taxpayer was derived from Wisconsin. It made an intelligent attempt to find such proportion of surplus, and in so doing, we submit, it clearly rewrote a whole section of the statute.

In short, the Wisconsin Department of Taxation was faced with an inescapable dilemma. It was told that it could not use the statutory formula, and yet it has no power to legislate and provide a formula of its own.

The conclusion seems inevitable that the administration of the tax has completely broken down.

Respectfully submitted,

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FILE COPY

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

STATEMENT OPPOSING JURISDICTION AND MOTION TO DISMISS OR AFFIRM.

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SUPREME COURT OF THE UNITED STATES

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APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

APPELLEE'S STATEMENT OPPOSING JURISDICTION.

Pursuant to Rule 12, Paragraph 3, of the Rules of the Supreme Court of the United States, Appellee filed this statement opposing jurisdiction.

Nature of the Case.

This is an appeal by the International Harvester Company from a judgment of the Supreme Court of the State of Wisconsin affirming an assessment against the Appellant of taxes for the period September 26, 1935 to October 15, 1937, both inclusive, imposed by the provisions of the Wisconsin Tax Law, commonly referred to as the Wiscon-

sin Privilege Dividend Tax Law, which was enacted by Laws of Wis. 1935, Ch. 505, Sec. 33, as amended by Laws of Wis. 1935, Ch. 552, and by subsequent legislative acts extended so that ever since it has been and now is presently operative.

The case was decided June 16, 1943 and is reported *International Harvester Company* v. *Department of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169, and motion for rehearing was denied September 14, 1943 (which has not as yet been reported, except in 11 N. W. (2) 95 (Adv. Sh., No. 3, October 27, 1943).

This appeal, and the decision of the Supreme Court of the State of Wisconsin from which it is taken, are an aftermath of the previous litigation in this Court in 1940 in which the Appellant in a present companion appeal, *Minnesota Mining & Mfg. Co.* v. *Wisconsin Department of Taxation*, was involved. In January, 1940 the Supreme Court of the State of Wisconsin had before it the constitutionality of the Wisconsin Privilege Dividend Tax Law, which the Appellant here challenges. In three companion cases, *J. C. Penney Co.* v. *Tax Comm.*, (1940) 233 Wis. 286, 289 N. W. 677; *F. W. Woolworth Company* v. *Tax Comm.*, (1940) 233 Wis. 305, 289 N. W. 685; and *Minnesota Mining & Manufacturing Company* v. *Tax Comm.*, (1940) 233 Wis. 307, 289 N. W. 686; that Court in an opinion in the *J. C. Penney Co.* case, which was made applicable to and the basis of the disposition of the other two cases, felt that *Connecticut General Life Ins. Co.* v. *Johnson*, (1938) 303 U. S. 77, 58 S. Ct. 436, 82 L. Ed. 673, required that it hold this Wisconsin Tax Law invalid and therefore did so. Upon certiorari in all three cases this Court, in an opinion rendered December 16, 1940 in the case involving the J. C. Penney Co. and made applicable to the other two cases, reversed the Supreme Court of Wisconsin and remanded the cases for the determination of such questions as were

open in light of this Court's opinion. *State of Wisconsin* v. *J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. Ed. 267; *State of Wisconsin* v. *Minnesota Mining & Manufacturing Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. Ed. 274; *State of Wisconsin* v. *F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. Ed. 395. The basis of this Court's reversal was a determination that the imposition of this tax is within the taxing jurisdiction of the State of Wisconsin. The taxes of the Appellant, Minnesota Mining & Manufacturing Co. in the companion appeal here at the same time as this case, that were involved in that case were the taxes assessed against it in respect to dividends paid during the year 1936, which taxes are likewise the taxes of one of the years involved in the present appeal.

Upon remand the cases were again heard, but the Supreme Court of the State of Wisconsin refused to reconsider the constitutionality of the statute, being bound by the decision of this Court, but did address itself to the matter of computation of the tax. It held that the tax had not been properly computed and remanded the cases for computation thereof in accordance with its opinion.

In those cases the taxes had been computed following the provision of the statute that in the absence of proof to the contrary dividends paid shall be presumed to have been paid out of earnings of the corporation of the year immediately preceding the payment of the dividend. The method of computation there used took the previous year's income of the corporation and ascertained the amount thereof attributable to Wisconsin by using the provisions of the Wisconsin Income Tax Law in Ch. 71, Wis. Stats., expressly made applicable. The percentage relationship was then applied to the dividend paid as determining the amount of Wisconsin income distributed by the dividend and the tax was then computed on that amount. As was

stated to this Court on the arguments of the cases above mentioned, if the dividends paid in a year exceeded the income of the corporation of the prior year, then such excess would be deemed paid out of the next previous year's income of the corporation and the percentage of Wisconsin income to the total income of such year would be applied to determine the amount of Wisconsin income of that year distributed by the dividend. This would be continued year by year until the total dividend payment would be accounted for and the tax applied to the amount of the dividend thereby attributed to Wisconsin income. On the remand the Wisconsin Supreme Court held that the presumption of the statute that the dividend is paid out of the prior year's earnings is rebuttable and that it being shown factually that the dividends were in fact paid out of surplus this rebutted the presumption. Accordingly it held the taxes were not properly computed and remanded the cases with directions to remand to the Commissioner of Taxation for further proceedings in accordance with the opinion. In the opinion, 238 Wis. 69, at 78, 79, the Court said:

> "* * * When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus. The Tax Commission treated the matter as if the statutory presumption were conclusive and gave no weight or consideration to the evidence. In this the Tax Commission was in error. It is said in briefs of counsel that it would be a Herculean task to compute the amount of surplus attributable to Wisconsin income. Inasmuch as the basis upon which the supreme court of the United States sustained the tax is that some

part of the dividend is allocable to Wisconsin income, we see no escape from the conclusion that no tax can be levied until that fact is ascertained."

Upon the return of the record the taxing authorities of the State of Wisconsin recomputed the taxes of the three taxpayer companies involved in said cases and gave to each of them a notice of the assessment thereof. As before stated, because the tax of the Appellant Minnesota Mining & Manufacturing Company that was there involved was only in respect to taxes on dividends paid in the year 1936, the recomputation and notice of assessment of the recomputed taxes included only the taxes for that year. However, as by that time the years 1937 to 1940 had passed and the Appellant Minnesota Mining & Manufacturing Company had paid dividends during those years, an assessment was made against it for taxes upon dividends paid in 1937 and another assessment for taxes upon dividends paid during the years 1938, 1939 and 1940, computing said taxes upon the basis set forth in the decision of the Supreme Court of Wisconsin on remand. This involved an analysis of the surplus of the taxpayer corporation as of the close of the year prior to the year in which the dividends were declared to ascertain the amount thereof which had been contributed by Wisconsin income and which represented Wisconsin income in said surplus. Having ascertained the percentage of relationship of Wisconsin income in surplus to the total thereof, that percentage was then applied to the dividends paid in the following year to arrive at the amount of said dividends that represented a distribution of Wisconsin income and the tax rate was then applied to that result. This was the method used also in the recomputation of the taxes against the J. C. Penney and F. W. Woolworth Companies. It is the method that has been used in all cases ever since the decision of the Supreme

Court of Wisconsin in the cases on remand. The Minnesota Mining & Mfg. Co. protested the assessment which was a recomputation of its 1936 taxes and also the new assessments for the subsequent years 1937 to 1940. The matters were successively heard as one case by the Wisconsin Board of Tax Appeals, the Circuit Court for Dane County, and the Supreme Court of Wisconsin. In a companion appeal to the instant appeal the Minnesota Mining & Mfg. Co. appeals to this Court from the decision by the Supreme Court of Wisconsin affirming said assessments, rendered on June 16, 1943, reported *Minnesota Mining & Manufacturing Co.* v. *Department of Taxation*, 243 Wis. 211, 10 N. W. (2) 174 and on September 14, 1943 denied a motion by the Appellant Minnesota Mining & Manufacturing Company for a rehearing thereon. Memorandum opinion on rehearing is not as yet reported, except in 11 N. W. (2) 96 (Adv. Sh., No. 3, October 27, 1943).

It is significant that at the same time that the Supreme Court was construing the case in which the present appeal is taken it also had before it four other cases involving various phases of this same Wisconsin Privilege Dividend Tax Law and that it rendered a decision therein on the same date as it rendered the decision in the instant case. These cases which were before that Court at that time comprised all of the attacks then being made before that court against this tax law. *Minnesota Mining & Manufacturing Co.* v. *Department of Taxation* (June 16, 1943), 243 Wis. 211, 10 N. W. (2) 174; rehearing denied September 13, 1943, but not reported except in 11 N. W. (2) 96 (Adv. Sh., No. 3, October 27, 1943). *Wisconsin Gas & Electric Co.* v. *Department of Taxation* (June 16, 1943), 243 Wis. 216, 10 N. W. (2) 140. *Blied* v. *Wisconsin Foundry & Machine Co.* (June 16, 1943), 243 Wis. 221, 10 N. W. (2) 142. *Montgomery Ward & Co.* v. *Department of Taxation* (June 16, 1943), 243 Wis. 224, 10 N. W. (2) 176.

Statutes Involved.

The Wisconsin Statutory Tax Law here involved is as set forth in the Appellant's statement as to jurisdiction under the heading: "The State Statute Involved", and in the interest of brevity will not be repeated. It is the same statute before this Court in the prior cases, except that by subsequent legislative enactments it has been extended from its original expiration date of July 1, 1937 so that it continuously has since been and is now presently operative up to and including July 1, 1945. In this connection it may be noted that the last extension of its operative effect to July 1, 1945 made by laws of Wisconsin, 1943, Ch. 367, sec. 2, changed the purpose of the statute and provides that the proceeds thereof

> "* * * shall be used to provide rehabilitation for returning veterans of World War II, construction and improvements of state institutions and other state property, and postwar public works projects to relieve postwar unemployment."

Facts.

The facts are as stated by the Supreme Court of Wisconsin:

> "Appellant is a New Jersey corporation, having its principal office in Hoboken, New Jersey. Its general executive offices are in Chicago. So far as the record discloses, it has done business in Wisconsin since 1920. The Wisconsin dividend privilege tax law was enacted and went into effect on September 26, 1935. From December 2, 1935, to October 15, 1937, appellant paid numerous dividends totaling $39,028,188.22, but did not pay any privilege dividend tax thereon. As of the end of the year 1934, the amount of surplus accumulated from Wisconsin earnings and constituting Wisconsin surplus on the basis of the formulae and method of computation prescribed by ch. 71, Stats., was $803,-

780.72. The amount attributable to Wisconsin as of December 31, 1935, was $2,227,499.03. The Wisconsin surplus as of October 31, 1936, was $2,608,908.26. On December 2, 1937, the Wisconsin Tax Commission, predecessor of Wisconsin Department of Taxation, notified appellant of an assessment of privilege dividend tax against it in the amount of $68,838.49, exclusive of penalties and interest, computation being based upon the statutory presumption that such dividends were paid out of previous years' earnings. Subsequently thereto, and because of the conceded rebuttal of the presumption, respondent recomputed the privilege divided tax at $53,713.29, exclusive of penalties and interest. There is a stipulation to the effect that, assuming the law to be valid and the method of computation authorized, the amount of the privilege tax as computed is correct. * * *"

No Substantial Federal Question Is Here Presented.

1. *Jurisdiction To Tax.*

(a) Authoritatively settled by *J. C. Penney Co. case.*

As previously pointed out this appeal involves the same statute and basically the same facts as in the prior cases, *State of Wisconsin* v. *J. C. Penney Co.* (1940), 311 U. S. 435, 61 S. Ct. 246, 85 L. Ed. 267; *State of Wisconsin* v. *Minnesota Mining & Mfg. Co.* (1940), 311 U. S. 452, 61 S. Ct. 253, 85 L. Ed. 274, and *State of Wisconsin* v. *F. W. Woolworth Co.* (1940), 311 U. S. 622, 61 S. Ct. 395, 85 L. Ed. 395. All of the arguments here made by Appellant were presented to this Court in those cases. So far as jurisdiction of the State of Wisconsin to impose the tax is concerned, there is no difference and it is submitted that these prior decisions completely preclude there being any substantial question and dispose of the matter conclusively.

(b) No conflict exists between the decisions of this Court and of the Supreme Court of Wisconsin.

By taking excerpts from the opinions and upon a basis of labels to be put on the tax, Appellant here endeavors to spell out that there is a conflict between the decisions of this Court and of the Supreme Court of Wisconsin and assert that this presents a substantial federal question as to jurisdiction to impose the tax. The best answer to any such contention is what the Supreme Court of Wisconsin said in its latest pronouncement on the subject in the opinion in this case, *International Harvester Co. v. Dept. of Taxation* (June 16, 1943), 243 Wis. 198, 10 N. W. (2) 169, in which a denial rehearing on September 14, 1943 has not as yet been reported except in 11 N. W. (2) 95 (Adv. Sh. No. 3, October 27, 1943).

That court was there presented with this same contention and said in that regard at 243 Wis. 198, 204-206; 10 N. W. (2) 169, 171 and 172:

> "Upon remand to determine such questions as were left open by the opinion of the United States supreme court, this court in *J. C. Penney Co. v. Tax Comm.* 238 Wis. 69, 298 N. W. 186, (1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States supreme court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called; and (4) made certain directions as to its computation. The latter point need not be elaborated in this portion of the opinion. From the briefs in this case, and the memorandum of the trial court, it appears to be concluded that we have here what the trial court designates an 'immaculate dilemma;' that the supreme court of the United States has held this to be an income tax, and that as such it is invalid under the Wisconsin constitution; that the supreme court of Wisconsin, upon remand, has persisted in designating it a privilege tax in which case the privilege being wholly exercised out-

side of the state, it is unconstitutional under the federal constitution.

"We see no such dilemma. As we read the opinion of the United States supreme court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned. What the United States supreme court has done is (1) to state the factual basis upon which this law must be treated as constitutional in so far as the jurisdiction of Wisconsin to levy it is concerned, and (2) to hold that given the factual basis, the law is constitutional in this aspect, regardless of the designation given it by this court. In other words, the federal supreme court has established the jurisdictional fact which is that the corporation paid the dividends in whole or in part out of property located in this state or business transacted here. If the term 'jurisdictional fact' must hereafter be relegated to the limbo of outmoded terms, the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from these activities are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the federal supreme court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.

"This being true, we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction. It makes no difference what this court calls the tax. It may, for other than constitutional reasons, be important to designate the tax a privilege tax, but the label has no bearing upon the controversy here. We adhere to our determination upon remand of the *Penney Case*, *supra*, that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that its constitutional justifica-

tion from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. Under the circumstances, we do not propose to re-examine contentions heretofore made and impliedly overruled that the law is void under the Wisconsin constitution. The constitutional question considered material and decided by this court in the original *Penney Case* involved the federal constitution and has been answered by the United States supreme court. We consider the matter to be closed."

(c) Method of computation of the tax is of no significance.

That the taxes are computed upon an analysis of surplus basis as directed by the Supreme Court of Wisconsin instead of by the prior method of deeming the dividends paid out of the most recent earnings of the corporation, is of no consequence. The method here used is the result of construction of the tax law by the Supreme Court of Wisconsin and has no relationship to any question of jurisdiction for it is used to determine the amount of income derived from Wisconsin that is distributed by the dividend. As said by both this Court and the Supreme Court of Wisconsin, the basis of the power to impose this tax is that the state has given its protection and the benefits of government to corporate activities in the state and that profits therefrom are distributed by the dividends paid.

In this connection Appellant here states, as it did before the Supreme Court of Wisconsin, that the Wisconsin Department of Taxation conceived the formula by which the tax is computed. Nothing could be more erroneous and the Supreme Court of Wisconsin at page 210 of its opinion in this case said:

"* * * The formula prescribed by this court upon remand in the *Penney Case*, supra, that is, that the

> Wisconsin earnings should constitute the numerator of a fraction of which the entire amount available for dividends is the denominator, is rational and workable and was applied in this case. * * *"

Likewise, Appellant here again, as it did before the Wisconsin Supreme Court unsuccessfully, urges that since the statute contains no specific formula for computing the tax, the Supreme Court cannot supply one.

It is submitted that these two last contentions are purely matters of construction of the Wisconsin statute, which this Court recognizes as being solely within the function and power of the Supreme Court of Wisconsin. We fail to see how the decision of the Supreme Court of Wisconsin against the Appellant on these two points could be said to present a federal question.

(d) Deductibility of the tax from the dividend remittance was before this Court in the prior cases.

Appellant makes reference to the recent decision of the Supreme Court of Wisconsin in the cases *Wisconsin Gas & Electric Co.* v. *Dept. of Taxation*, (June 16, 1943) 243 Wis. 216, 10 N. W. (2) 140 and *Blied* v. *Wisconsin Foundry & Machine Co.*, (June 16, 1943) 243 Wis. 221, 10 N. W. (2) 142. In the first case just mentioned it was held that a corporation is not entitled under the Wisconsin income tax law to deduct privilege dividend taxes imposed against and paid by it. The second case held a stockholder is not entitled to recover from the corporation the amount of privilege dividend tax withheld by the corporation in making remittance of the dividend, basing its decision on the specific requirements of the Wisconsin Privilege Dividend Tax Law that the tax shall be so deducted and holding such statutory provisions valid. In the *Wisconsin Gas & Electric Co.* case, the opinion unequivocally points out that when this Court

made its decisions in the prior cases the statute was before it and contained the provision which plainly puts the *burden* of the tax on the stockholder. But, that is not all, the provision was called to this Court's attention in those cases, and was made the basis of argument by the Respondents as establishing invalidity of the tax law.

2. *The Privilege Dividend Tax is not a retroactive tax.*

Appellant urges that, because the surplus is made up of accumulated income of past years, computation of the tax by analysis of the surplus to determine the amount in the surplus that is attributable to Wisconsin sources and applying the percentage relationship thereof to ascertain the amount of the dividend which paid out of income attributable to Wisconsin sources, renders it void as a retroactively taxing of income earned prior to the enactment of this tax law. This, obviously, is entirely inconsistent with Appellant's position that the tax is a transaction or privilege tax and that as the transaction or exercise of the privilege takes place outside of the state the law is invalid as taxing something beyond the jurisdictional limits of the state.

If the tax is not an income tax, and the Supreme Court of Wisconsin says it is not, but a privilege tax, then all that occurs is the measurement of the tax by the value of the privilege. In this connection it is most important that it be kept in mind that the tax is not imposed for the privilege alone of receiving dividends out of income derived from Wisconsin income nor alone for the privilege of declaring dividends therefrom, but for *both*. Most of the erroneous concepts in reference to this tax arise from a failure to notice or appreciate the significance thereof.

This tax is not a retroactive tax. It is a tax imposed upon and at the time of an occurrence,—namely, the dis-

tribution or devolution to stockholders of corporate earnings. It is a *present* tax imposed at the time of and on a *present* transfer or devolution. It imposes the tax in the year the dividend is paid and measures the tax by the amount of the dividend that is attributable to Wisconsin sources.

It is no more a retroactive tax than the taxation of a capital gain in the year of sale of the asset, when the profit or gain results from a sale at a price in excess of the cost when purchased years prior thereto. There the tax is imposed at the time of and measured by the value of the realization of profit. So here the tax is laid at the time of the realization by the stockholder of the fruits that have grown on the corporate tree and which is the realization upon the ultimate purpose he had in owning stock in the corporation and its conducting of business for profit. It is no more a retroactive tax than when an income tax is imposed upon a stockholder for corporate dividends received by him. The dividends if paid from surplus which is made up of accumulations of income of prior years effects a distribution of such accumulations and yet the tax is not deemed retroactive. The tax here is merely measured by the amount of Wisconsin earnings distributed and when they are utilized as such by way of dividend. For the purposes of the dividend such accumulations are still income or profit, for the corporation admittedly is not making a liquidating dividend but a regular dividend which is and must be a distribution of its profits. Even were the tax viewed as an income tax, which it is not, it would be taxing the corporation on the distribution of income and the stockholder on the receipt of income. Under Appellant's own argument that the tax is on the stockholder its argument would have to fall as to retroactivity for certainly then the analogy to the well recognized imposition of an income tax

on the stockholder on the dividend received would be complete.

From the foregoing it is submitted that the decision of the Supreme Court of Wisconsin is in accord with the decision of this Court and is so plainly right as not to require argument, and therefore no substantial federal question is presented.

Respectfully submitted,

JOHN E. MARTIN,
Attorney General of Wisconsin.
JAMES WARD RECTOR,
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HAROLD H. PERSONS,
Assistant Attorney General of Wisconsin.
Counsel for Appellee.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

MOTION TO DISMISS APPEAL OR AFFIRM.

Comes now the Wisconsin Department of Taxation, Appellee herein, by its counsel below and moves this Court to dismiss, with costs, the appeal taken herein to this Court by International Harvester Company from the Judgment of the Supreme Court of the State of Wisconsin, dated June 16, 1943, upon the following grounds:

1. No substantial federal question is presented.

2. The decision of the Supreme Court of Wisconsin is so plainly right as not to require reargument.

In the alternative Appellee moves this Court to affirm on the ground that the questions on which the decision of the cause depends are so unsubstantial as not to need further argument.

Dated this 28th day of December, 1943.

JOHN E. MARTIN,
Attorney General of Wisconsin,
JAMES WARD RECTOR,
Deputy Attorney General of Wisconsin,
HAROLD H. PERSONS,
Assistant Attorney General of Wisconsin,
Counsel for Appellee.

Supreme Court of the United States

October Term, 1945

Nos. 680 and 681

INTERNATIONAL HARVESTER COMPANY, *Appellant*,

vs. (No. 680)

WISCONSIN DEPARTMENT OF TAXATION, *Appellee*.

MINNESOTA MINING AND MANUFACTURING COMPANY, *Appellant*,

vs. (No. 681)

WISCONSIN DEPARTMENT OF TAXATION, *Appellee*.

APPEALS FROM THE SUPREME COURT OF THE STATE OF WISCONSIN

BRIEF OF APPELLEE

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IN THE

Supreme Court of the United States

October Term, 1943

Nos. 620 and 621

INTERNATIONAL HARVESTER COMPANY, *Appellant*, *vs.* WISCONSIN DEPARTMENT OF TAXATION, *Appellee.*	(No. 620)
MINNESOTA MINING AND MANUFACTURING COMPANY, *Appellant*, *vs.* WISCONSIN DEPARTMENT OF TAXATION, *Appellee.*	(No. 621)

APPEALS FROM THE SUPREME COURT OF THE STATE OF WISCONSIN

BRIEF OF APPELLEE

The appellee is the same in the above entitled cases and this brief is submitted on its behalf as a joint brief for both cases.

Although the detailed facts are different in each case by virtue of there being separate appellant taxpayers and the conduct by each of its respective business and affairs, yet the same basic factual situation exists in both cases.

To the extent there is any difference in the detailed facts material to the questions involved the same will be separately treated.

The Supreme Court of Wisconsin heard and decided the cases at the same time, and upon the same grounds, its decision in the *International Harvester Co.* case, No. 620 here, being expressly made the basis of, and incorporated by reference in, its decision in the *Minnesota Mining & Mfg. Co.* case, No. 621 here.

The questions of law here presented by the appellants are essentially the same and separate briefs by appellee would be repetitious. To the extent any arguments are made not common to both they will be dealt with specifically.

The facts relating to each case will be hereinafter separately stated. In other respects, the contents hereof, except as otherwise specifically stated, apply equally to both cases.

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin in Case No. 620 (R. 60-69) is reported *International Harvester Co. v. Dept. of Taxation* (June 16, 1943) 243 Wis. 198, 10 N. W. (2) 169, and an opinion on denial of rehearing (R. 71) on September 14, 1943 is not as yet printed in the official reports but is reported 11 N. W. (2) 95.

The opinion of the Supreme Court of Wisconsin in Case No. 621 (R. 102-105) is reported *Minnesota Mining & Mfg. Co. v. Dept. of Taxation,* (June 16, 1943) 243 Wis. 211, 10 N. W. (2) 174. But it can only and *must* be read and considered in conjunction with that court's opinion rendered at the same time in Case No. 620 reported as stated above *International Harvester Co. v. Dept. of Taxation,* (June 16, 1943) 243 Wis. 198, 10 N. W. (2) 169. Likewise an opinion on denial of a rehearing in this case No. 621 (R. 106-107) on September 14, 1943 is not as yet

printed in the official reports but is reported 11 N. W. (2) 96.

Jurisdiction

Judgment of the Supreme Court of Wisconsin both cases was entered June 16, 1943. (No. 620, R. 60; No. 621, R. 102) Petition for allowance of appeal to this Court was filed and granted December 11, 1943 in both cases. (No. 620, R. 1-3; No. 621, R. 1-3). Probable jurisdiction was noted February 28, 1944 in both cases. (No. 620, R. 73; No. 621, R. 110)

Jurisdiction of this Court is rested on Section 237 (a) of the Judicial Code.

QUESTION PRESENTED

Whether the imposition of taxes by the Wisconsin Privilege Dividend Tax Law, Section 3 of Chapter 505 of the Laws of Wisconsin of 1935, upon foreign corporations licensed to do business in Wisconsin offends the due process provisions of the Fourteenth Amendment?

Statutes Involved

The Wisconsin Privilege Dividend Tax Law, Section 3 of Chapter 505 of the Laws of Wisconsin of 1935, effective on its publication on September 26, 1935, and as amended by Chapter 552 of the Laws of Wisconsin of 1935 is printed in the Appendix to this brief.

While originally this tax was operative only to July 1, 1937, it has been subsequently re-enacted in 1937, 1939, 1941 and 1943 by the following Acts of the Wisconsin legislature and is now operative:

(1) Section 37, Chapter 309 of the Laws of Wisconsin of 1937, (enacted and effective on its publica-

tion June 30, 1937) extended its operation to July 1, 1939.

(2) Section 1 of Chapter 198 of the Laws of Wisconsin of 1939 (enacted and effective on its publication on June 30, 1939) extended its operation to July 1, 1941, and also increased the rate from 2½% to 3% thereafter.

(3) Section 3 of Chapter 63 of the Laws of Wisconsin of 1941 (enacted and effective upon its publication April 30, 1941) extended its operation to July 1, 1943.

(4) Section 2 of Chapter 367 of the Laws of Wisconsin of 1943 (enacted and effective on its publication June 30, 1943) extended its operation to July 1, 1945 and also changed the purpose for which such taxes shall be used from general state expenditure, providing:

> "* * * rehabilitation for returning veterans of World War II, construction of improvements at state institutions and other state property, and postwar public works projects to relieve postwar unemployment."

This is the identical Wisconsin tax statute previously considered and held to be valid by this Court in *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267; *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274; *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395.

STATEMENT OF THE CASES

Summary of Facts in International Harvester Co. Appeal, No. 620.

The facts are not in dispute. The appellant, International Harvester Company, is a New Jersey corporation, having its principal office in Hoboken, New Jersey. Its general executive offices are in Chicago, Illinois. It has

manufacturing plants and sales branches in many states. It has done business in Wisconsin and been duly licensed to do so since 1920. The meetings of its board of directors at which dividend resolutions were adopted and all acts in paying dividends took place in Chicago where its treasury departments drew and mailed out checks on appellant's bank accounts in Chicago and New York to its stockholders numbering more than 32,000 who were in every state of the United States and in many foreign countries. Less than 2% of its stockholders were residents of Wisconsin.

The Wisconsin Privilege Dividend Tax Law was enacted and went into effect on September 26, 1935. From December 2, 1935 to October 15, 1937 the appellant International Harvester Co., paid numerous dividends totalling $39,028,188.22, but did not pay any privilege dividend tax thereon. Such dividends were charged to surplus which resulted from and reflected the accumulated net profits and income from property wherever located and business wherever transacted.

At the end of the year 1934, the amount of surplus accumulated from Wisconsin earnings and constituting Wisconsin surplus on the basis of the formulae and method of computation prescribed by Chapter 71, Wisconsin Statutes, was $803,780.72. The amount attributable to Wisconsin as of December 31, 1935, was $2,227,499.03. The Wisconsin surplus as of October 31, 1936, was $2,608,908.26.

On December 2, 1937 the Wisconsin Tax Commission (predecessor to the appellee Wisconsin Department of Taxation) notified the appellant of an assessment of privilege dividend taxes against it of $68,838.49, exclusive of penalties and interest, computed upon the basis of the statutory presumption that the dividends were paid out of the previous year's earnings. Subsequent thereto, and because of the decision by the Supreme Court of Wisconsin in *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186, upon the remand from this Court in the prior cases

Wisconsin v. J. C. Penney Co., (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267; *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274; *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395, the appellee, Wisconsin Department of Taxation, followed the directions of the Supreme Court in respect to the computation of the tax and recomputed such taxes at $53,713.29, exclusive of penalties and interest.

There is a stipulation in this case to the effect that, assuming the law to be valid and the method of computation authorized, the amount of the taxes as computed is correct. (Case No. 620, R. 30 and 31) The attention of the Court is particularly directed to this stipulation because as will be discussed later, notwithstanding this stipulation counsel for the appellant International Harvester Co. make arguments that are foreclosed by and contrary to this stipulation which they entered into.

Summary of Facts in Minnesota Mining & Mfg. Co. Appeal, No. 621

The facts are identical with those presented in the prior case of *State of Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274, with the exception that the taxes are here computed by using the surplus analysis method ordered by the Wisconsin Supreme Court in its decision on remand from this Court, with the result that the taxes are less in amount than if computed as in the prior case. The assessment here involved also includes not only the year 1936, which was the only year covered by the prior case, but also the subsequent years 1937 to 1940, both inclusive.

The facts are not in dispute and are as stated by the Supreme Court of the State of Wisconsin in its opinion

in this case, *Minnesota Mining & Mfg. Co. v. Dept. of Taxation,* (June 16, 1943) 243 Wis. 211, at 213, 10 N. W. (2) 174, as follows: (Case No. 621, R. 102-104)

> "The facts in this case are not in substantial dispute. Appellant is a Delaware corporation, with its principal office and place of business in St. Paul, Minnesota. It operates a factory at Wausau, Wisconsin, manufacturing roofing granules. This factory began manufacturing operations in 1930. Sales are made through an office in Chicago but orders are confirmed at the St. Paul office. When products so manufactured are sold, the remittances are made directly to the home office at St. Paul, and the funds from such sales are deposited in the general account of the appellant. Pay-rolls, together with pay-checks, are prepared at the St. Paul office and drawn on a Wausau bank, and a deposit equalling the amount of the pay-roll is forwarded to the Wausau bank to cover the checks at approximately the same time that the checks representing the pay-roll are forwarded. The company reports upon a calendar year basis, closing books as of December 31, each year. It maintains one general surplus account and none of the earnings from property located, or business transacted in Wisconsin are segregated in any way. It maintains no separate balance sheet for Wisconsin operations. Dividends are declared by the Board of Directors of the company at meetings held in St. Paul; the First Trust Company of that city being the company's transfer agent. All dividends are paid to this transfer agent by check drawn upon a St. Paul bank and distributed to the stockholders by the transfer agent. Dividends are paid from surplus.

Computation of the Taxes in Both Cases.

The following excerpt from the opinion of the Supreme Court of Wisconsin in *Minnesota Mining & Mfg. Co. v. Dept. of Taxation,* (1943) 243 Wis. 211, 213, 10 N. W. (2) 174, sets forth the manner in which the taxes were computed:

"In making the assessments, the department of taxation analyzed the surplus on December 31st of the year preceding that in which a particular dividend was paid. In this analysis, the department went back to the date on which the corporation commenced doing business in Wisconsin for the purpose of determining (1) total surplus existing at that time, (2) the ratable contribution of earnings in Wisconsin to the surplus as of December 31st, prior to the declaration of the dividends. The department selected the close of the year preceding the payment of the dividend as the basis of its computations rather than the surplus at the time of the payment or receiving of the dividend, it being the view of the department that unless the corporation had closed its books and taken inventory at the time of the payment of the dividend (in which case analysis would have been made as of that time) it would be impossible to revise the surplus as of each dividend paying date. The dividends were paid out of the corporation's general account. There never was any attempt made to earmark any of the earnings coming from Wisconsin or other states, although the corporation did business in all of the other states of the Union."

ARGUMENT

Summary of Argument

PREFACE showing these appeals are rested upon a predicate that is nonexistent. In urging that there is a conflict between the decisions of this Court and of the Supreme Court of Wisconsin appellants fail to set out the express statement in the decisions here appealed from, where it unequivocally disavows any such conflict.

POINT I. NO CONFLICT EXISTS BETWEEN THE DECISIONS OF THIS COURT AND OF THE SUPREME COURT OF WISCONSIN. The latter in *State ex rel. Froedtert G. & M. Co. v. Tax Comm.* (1936) 221 Wis. 225, 265 N. W. 672 affirmed this law, and in *J. C. Penney Co. v. Tax Comm.* (1940) 233 Wis. 305, 289 N. W. 677, and companion cases, it held the tax invalid solely upon its interpretation of the applicability of *Connecticut General Life Insurance Co. v. Johnson,* (1938) 303 U. S. 77, 58 S. C. 436, 82 L. ed. 673. The decision of this Court in *Wisconsin v. J. C. Penney Co.* (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267 clarified this point and the tax was sustained upon the same basis that the Supreme Court of Wisconsin sustained it in the instant cases. The legislative history of re-enactments of this tax law are such that the courts' interpretations became an integral part thereof, and so this tax law cannot be given any other or different operation or effect. Reliance thereon in such re-enactments in preparing and providing for fiscal affairs of the state renders it obligatory that such effect be given this law thereafter, otherwise there would be no certainty or continuity in the fiscal matters of the state.

POINT II. THIS COURT DID NOT HOLD THE TAX AN INCOME TAX AGAINST THE CORPORATION. All that this Court held in the prior cases is that the tax is one that supplements the normal state income tax, but it did not hold it to be an income tax. It rested jurisdiction to impose this tax upon that same basis that supports an income tax—namely benefits conferred by the state.

POINT III. THE SUPREME COURT OF WISCONSIN DID NOT HOLD THAT THIS TAX IS IMPOSED

UPON THE STOCKHOLDER All the Supreme Court of Wisconsin held in *Wisconsin Gas & Electric Co. v. Dept. of Taxation* (1943) 243 Wis. 216, 10 N. W. (2) 140 is that the tax does not qualify as a deduction from gross income under Section 71.03 (4) Wisconsin Statutes in computing Wisconsin income taxes, as a tax on the "property or business" producing the income subjected to such income tax: In *Blied v. Wis. Foundry & Machine Co.* (1943) 243 Wis. 221, 10 N. W. (2) 142 it merely held that, this tax law providing that the privilege dividend tax may be deducted from the dividend, it must be applied and is valid, which case was between a Wisconsin stockholder and a Wisconsin corporation.

POINT IV. THE TAX IS CLEARLY WITHIN THE TAXING JURISDICTION OF THE STATE OF WISCONSIN. Court in testing validity of a tax is not concerned with labels or words, but only practical operation of the tax. If imposed in relation to benefits conferred by the state it is within the state's jurisdiction. There is reasonable relationship between this tax and protection afforded both in earning the accumulated income used to pay the dividend and in preserving the property in Wisconsin (including a representative proportion of the company's surplus made up of accumulated earnings) in the year of declaration and payment of the dividend. Tax is measured only by the amount of dividends paid that have resulted from earnings derived from and preserved by the protection and beneficial effect of Wisconsin laws. Purpose of corporate activity in the state is to acquire and have earnings to distribute to stockholders, who are the real beneficiaries of the protection and benefits thus conferred by the state. The tax is a transfer tax—a tax on the devolution of the benefits to the intended beneficiary at the time he realizes the same. Surplus is not represented by any particular property. When a corporation with surplus does business in the state the proportionate part of the surplus derives benefit from and is protected by the law of that state during that time, regardless of when the funds or earnings therein were acquired. Benefit of doing business under a state's laws cannot be measured by *quid pro quo* concept of license fees or taxes exacted during that time or by any cost basis of governmental expenditures during that time.

Governmental operations are result of expenditures over long periods of time, in the past and spread over periods in the future. Upon principle the tax is valid whether against the corporation or against the stockholders.

POINT V. THE PRIVILEGE DIVIDEND TAX IS NOT A RETROACTIVE TAX. It imposes a present tax upon a present occurrence—a transfer taking place subsequent to and during the life of the tax law. It is entirely different even from the tax in *Welch v. Henry*, (1937) 223 Wis. 319, 271 N. W. 68, 226 Wis. 595, 277 N. W. 183, affirmed 305 U. S. 134, 59 S. Ct. 121, 82 L. ed. 87, where a tax was imposed upon dividends in a year subsequent to the year of receipt and was truly a retroactive tax. The thing there taxed had occurred before the tax law was enacted. Here the thing taxed—the transfer—is taxed in the year that it takes place. Viewed as a tax on the stockholder there is no conceivable basis for contending it is retroactive.

Preface showing these appeals are rested upon a predicate that is nonexistent but maintained by appellants through improper and unjustifiable presentation thereof

These appeals, as stated by the Supreme Court of Wisconsin in its decision in *International Harvester Co. v. Dept. of Taxation*, (June 16, 1943) 243 Wis. 198, 201, 10 N. W. (2) 169, which opinion is specifically made applicable as well to *Minnesota Mining & Mfg. Co. v. Dept. of Taxation*, (June 16, 1943) 243 Wis. 211, 10 N. W. (2) 174, are another chapter in the long history of litigation concerning the Wisconsin Privilege Dividend Tax Law, in which the controversy developed has been but a mere battle of words and labels, during which the Supreme Court of Wisconsin passed upon the constitutionality of this law and its proper construction four times and this Court has considered the matter once.

The present appeal by the Minnesota Mining & Mfg. Co. in No. 621 involves the same statute, the same tax-

payer and the same basic facts as in the prior case of *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274, in which case and the two companion cases, *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267, and *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395, this Court affirmatively held that the imposition of this tax is within the taxing jurisdiction of the State of Wisconsin. The only differences between this appeal by the Minnesota Mining & Mfg. Co. in No. 621, and the prior case in this court involving this same appellant are: (1) that taxes for the subsequent years, 1937 to 1940 are also here included, and (2) the Supreme Court of Wisconsin has construed said law as to the proper method of computation of the tax, which it had not previously done when the cases were here last, because of its view as to the force of the decision in *Connecticut General Life Ins. Co. v. Johnson*, (1938) 303 U. S. 77, 58 S. Ct. 436, 82 L. ed. 673, and the method so prescribed by the Supreme Court of Wisconsin has been followed in computing the taxes here involved.

Basically the same arguments that are here made by the appellants in both cases Nos. 620 and 621 in attacking the validity of this tax law in respect to jurisdiction to tax were urged when said cases were last before this Court; again to the Supreme Court of Wisconsin upon the hearing of said cases on remand from this Court; and also when the instant companion cases were again before the Supreme Court of Wisconsin at the time it rendered its decisions in these cases, *Minnesota Mining & Mfg. Co. v. Dept. of Taxation*, (June 16, 1943) 243 Wis. 211, 10 N. W. (2) 174; *International Harvester Co. v. Dept. of Taxation*, (June 16, 1943) 243 Wis. 198, 10 N. W. (2) 169, and in the three other cases under consideration at the same time, *Wisconsin Gas & Electric Co. v. Dept. of Taxation*, (June

16, 1943) 243 Wis. 216, 10 N. W. (2) 140; *Blied v. Wisconsin Foundry & Machine Co.*, (June 16, 1943) 243 Wis. 221, 10 N. W. (2) 142, and *Montgomery Ward & Co. v. Dept. of Taxation*, (June 16, 1943) 243 Wis. 224, 10 N. W. (2) 176.

The arguments now made here by the appellants, International Harvester Co. in Case No. 620 and Minnesota Mining & Mfg. Co. in Case No. 621 are but a repetition of the same arguments that have been made to the Supreme Court of Wisconsin a number of times without success. Ever since the decision of this Court in the prior cases there has been an unsuccessful but relentless endeavor to effect the existence of a conflict between the decisions of this Court and of the Supreme Court of Wisconsin. The appellant Minnesota Mining & Mfg. Co. both on remand from this Court and subsequently has persisted in misconceiving this Court's decisions in the prior cases. It was vehemently asserted to the Supreme Court of Wisconsin upon remand *inter alia* that this Court held the tax is a supplemental income tax against the corporation and sustained it as within the taxing jurisdiction of the state solely as such; that the Supreme Court of Wisconsin had not so regarded the tax and therefore it should either adhere to its prior decisions and hold the tax invalid because this Court had sustained the tax as being totally different from what it is or hold that the tax is an income tax; and that in any event the tax is not against the corporation because of the deductibility provisions but upon the stockholders and therefore not sustained by this Court's decisions in the prior cases.

Notwithstanding all this the Supreme Court of Wisconsin sustained the tax on remand and addressed itself to construing the law as to computation of the tax. *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186 (upon remand). It held that the fact of payment of

the dividends from surplus rebuts the statutory presumption of payment from earnings of the most recent years because:

> "* * * When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for 1935 but to the whole amount of the surplus. * * *". (p. 78)

and remanded the case for recomputation of the tax upon that basis.

Then when the instant cases, involving the *International Harvester Co.* and the *Minnesota Mining & Mfg. Co.* and the other three recent *Wisconsin Gas & Electric Co.*, *Bliel* and *Montgomery Ward & Co.* cases, came before the Supreme Court of Wisconsin, the same propositions were even more strenuously urged. The purpose in presenting them was to have a basis for contending that as an income tax against the corporation it is not sustainable under Wisconsin law and also would be invalidly retroactive, and that as a tax against the stockholders it is beyond the taxing jurisdiction of Wisconsin. Again such endeavors were of no avail and the Supreme Court of Wisconsin sustained the tax, *specifically stating* that no such conflict exists and that the fundamentals expressed in the decision of this Court in the prior cases clearly sustain the tax as valid. *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169; *Minnesota Mining & Mfg. Co. v. Dept. of Taxation*, (1943) 243 Wis. 211, 10 N. W. (2) 174.

But, notwithstanding all this, in the Brief of Appellant in both of the appeals here it is "dogmatically" asserted that such conflict exists and the entire attack is predicated upon the existence of such a conflict. At the very outset, this postulate of the appellant is vigorously denied by appellee for the reason that no such conflict exists. This will be demonstrated later in this brief. The method by which appellants here endeavor to build up the existence of such a conflict is by taking isolated phrases and parts of the various opinions torn from their context and setting them off one against another.

In the first place, as to the value thereof, the following appears pertinent:

> "Perhaps there is no practice contributing more greatly to confusion in legal conception or more fruitful of litigation than that of wresting a line or phrase from its context in an opinion and attempting to apply it to an entirely dissimilar set of facts." *Matter of Davidson*, (1930 N. Y.) 137 Misc. 852-858.

In the second place, it is done by the appellant Minnesota Mining & Mfg. Co. in its brief not only unjustifiably, but by what would appear to be by a purposely unfair method.

At pages 13 to 19 of Brief of Appellant by counsel for Minnesota Mining & Mfg. Co. the position of the appellant in this regard is set out. It is there urged that this Court sustained this law as a supplementary income tax on the corporation; that the Wisconsin Supreme Court in its decision on remand, *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186, vehemently held that the tax was not an income tax on the corporation; and that the decisions of the Supreme Court of Wisconsin in that case and in the other five recent cases (which includes the decision in the instant case) in which decisions were rendered on June 16, 1943, construed this tax law so as to

now remove the basis upon which this Court upheld this tax law in the *Penney* case. It is then asserted this is true because there is a basic conflict in the construction of this law between the decision of this Court and the decisions of the Supreme Court of Wisconsin and to support this presents an excerpt from the decision of the Circuit Court for Dane County, Wisconsin, not in this case, but in the companion *International Harvester Co.* case in that court.

Then in a folded insert at page 18 counsel for the Minnesota Mining & Mfg. Co. commit what to us, especially in view of their quotation on pages 17 and 18 from the Circuit Court decision in the companion *International Harvester* case, is a most improper and unfair presentation. In this folded insert appellant's counsel sets forth in columnar form detached sentences and quotations from various opinions, but wholly omits any quotation from the decision of the Supreme Court of Wisconsin in *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169, which opinion is specifically referred to and incorporated in the opinion by the Supreme Court of Wisconsin in the instant case involving the Minnesota Mining & Mfg. Co. In fact the importation of that opinion into the decision in this case and the failure to quote therefrom means that the comparison in the folded insert does not include the very decision in the case from which the appeal here is taken.

This in and of itself standing alone might not be serious, but for the fact that in *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169, at page 205, the Supreme Court of Wisconsin specifically addressed itself to this point at a time when the identical arguments (including a columnar comparison of almost the same content) that are now made here as the basis of the appellant's present attack on the constitu-

tionality of this statute had been made to it, and said at pages 205 and 206:

> "* * * The latter point need not be elaborated in this portion of the opinion. From the briefs in this case, and the memorandum of the trial court, it appears to be concluded that we have here what the trial court designates an 'immaculate dilemma'; that the supreme court of the United States has held this to be an income tax, and that as such it is invalid under the Wisconsin constitution; that the supreme court of Wisconsin, upon remand, has persisted in designating it a privilege tax in which case the privilege being wholly exercised outside of the state, it is unconstitutional under the federal constitution.
>
> "We see no such dilemma. As we read the opinion of the United States supreme court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned. What the United States supreme court has done is, (1) to state the factual basis upon which this law must be treated as constitutional in so far as the jurisdiction of Wisconsin to levy it is concerned, and (2) to hold that given the factual basis, the law is constitutional in this aspect, regardless of the designation given it by this court. In other words, the federal supreme court has established the jurisdictional fact which is that the corporation paid the dividends in whole or in part out of property located in this state or business transacted here. If the term 'jurisdictional fact' must hereafter be relegated to the limbo of outmoded terms, the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from these activities are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the federal supreme court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.
>
> "This being true; we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdic-

> tion. It makes no difference what this court calls the tax. It may, for other than constitutional reasons, be important to designate the tax a privilege tax, but the label has no bearing upon the controversy here. We adhere to our determination upon remand of the *Penney Case, supra*, that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that this constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. Under the circumstances, we do not propose to re-examine contentions heretofore made and impliedly overruled that the law is void under the Wisconsin constitution. The constitutional question considered material and decided by this court in the original *Penney Case* involved the federal constitution and has been answered by the United States supreme court. We consider the matter to be closed."

This omission in this line of argument is unpardonable. Not only does this omitted quotation demonstrate that the Supreme Court of Wisconsin is in perfect accord with this Court upon the jurisdictional question and has in no manner construed this statute so as to give rise to any such conflict as is asserted by the appellants, but a reading of the opinions in *toto* from which the handpicked snatches set forth in the folded insert are lifted shows that the import of all of them is that the basic fundamentals upon which jurisdiction to impose this tax is sustained are the same in this Court and in the Supreme Court of Wisconsin.

As previously indicated this last will be elaborated on later in this brief, but at the outset it is desired to show the utter lack of merit in appellants' thesis, which must be apparent to the appellants' counsel, otherwise it is unexplainable why this positive statement by the Supreme Court of Wisconsin squarely on the point is neither included in the insert following page 18 in the Brief of Appellant Minnesota Mining & Mfg. Co. nor anywhere else either in the Brief of Appellant Minnesota Mining & Mfg. Co. nor

in the Brief of Appellant International Harvester Co.

This matter has been dwelt upon at some length because it not only is most unfair to this Court and to the Supreme Court of Wisconsin, but a serious matter that may not be passed off lightly when made the basis of an attack upon a tax law that is of such importance in the fiscal affairs of the State of Wisconsin. Reference to the official records and the published official Reports of the Wisconsin Department of Taxation shows the following as to just how serious it is:

Calendar Year	*Privilege Dividend Tax Collected*
1935 (2½ months)	$ 20,732.52
1936	944,941.24
1937	1,993,361.72
1938	1,535,431.52
1939	1,323,553.97
1940	1,679,254.72
1941	2,745,781.61
1942	2,490,824.75
1943	2,663,822.60
1944 (3 months)	815,028.64
Total	$16,212,733.29

Furthermore, as showing the importance thereof, is the re-enactment of this tax statute by the legislature of Wisconsin four times since the decision by the Supreme Court of Wisconsin in *State ex rel. Froedtert G. & M. Co. v. Tax Comm.*, (1936) 221 Wis. 225, 265 N. W. 672, 267 N. W. 52, and twice subsequent to the decisions in 1940 by this Court in the prior cases. By these re-enactments the legislature used the language of the statute as meaning, saying and having the effect as set forth in said decisions. It is thus inescapable that the legislature so intended and that this statute thereafter could not and cannot be held to provide

otherwise than as interpreted and sustained in such decisions.

Of somewhat the same character is the way in which the briefs by both appellants make various references to the method of computation of the tax in such a manner as to infer that the surplus analysis method is the creature of and was promulgated by the Wisconsin Department of Taxation. The use of such surplus analysis method was specifically directed by the Supreme Court of Wisconsin in *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186 (upon remand) and, in the decision in the companion case, *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 210, 10 N. W. (2) 169, it said:

> "* * * The formula *prescribed by this court upon remand* in the Penney Case, supra, that is, that the Wisconsin earnings should constitute the numerator of the fraction of which the entire amount available for dividends is the denominator, is rational and workable and was applied in this case. * * *" (Emphasis supplied)

I. NO CONFLICT EXISTS BETWEEN THE DECISIONS OF THIS COURT AND THE SUPREME COURT OF WISCONSIN.

The Privilege Dividend Tax Law, as originally enacted by Section 3, Chapter 505, Laws of 1935, and amendments thereto, first came before the Supreme Court of Wisconsin in *State ex rel. Froedtert G. & M. Co. v. Tax Comm.*, (1936) 221 Wis. 225, 265 N. W. 672. In the opinion in that case the court held, and the mandate expressly provided, as follows:

> "It is declared and adjudged that sec. 3, ch. 505, Laws of 1935, as amended by ch. 552, Laws of 1935, does not violate the constitution of the state of Wis-

consin or the constitution of the United States, and is valid." (p. 240)

A motion for re-hearing was thereafter made and denied. In connection with this motion for re-hearing it was vigorously argued that the law was invalid as applied to foreign corporations, that it was not severable, and that consequently it was invalid as applied to domestic corporations. In the opinion denying the re-hearing, reported 221 Wis. 240, 267 N. W. 52, that court expressly passed upon the question and held the law valid as applied to foreign corporations.

Subsequent to this *Froedtert* case this Court rendered its decision in *Connecticut General Life Insurance Co. v. Johnson*, (1938) 303 U. S. 77, 58 S. Ct. 436, 82 L. ed. 457. The Supreme Court of Wisconsin interpreted the opinion in that case as expressing a position that made the Privilege Dividend Tax Law invalid as violative of the Fourteenth Amendment. Consequently it felt obliged to follow said decision and therefore, solely on that basis, overrule its former decision and hold the tax law violative of the provisions of the United States Constitution. *J. C. Penney Co. v. Tax Comm.*, (1940) 233 Wis. 286, 289 N. W. 677; *F. W. Woolworth Co. v. Tax Comm.*, (1940) 233 Wis. 305, 289 N. W. 685; *Minnesota Mining & Mfg. Co. v. Tax Comm.*, (1940) 233 Wis. 306, 289 N. W. 686.

Upon *certiorari* this Court clarified this and expressly held that its decision in the *Connecticut General Life Insurance Co.* case is not to be interpreted as making the Privilege Dividend Tax Law violative of the United States Constitution. *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267; *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274; *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395.

This Court sustained the tax upon the same basis

that the *Froedtert* case was decided and approved the principles thereof. In *State ex rel. Froedtert G. & M. Co. v. Tax Comm.*, (1936) 221 Wis. 225, 265 N. W. 672, 267 N. W. 52, the privilege dividend tax was sustained as a tax upon the transfer or devolution from a corporation to its stockholders of income earned out of corporate property located in Wisconsin and corporate business transacted in Wisconsin. The basis of the power of the state to tax such a transfer was rested by that court upon the circumstance that the earnings transferred were earned in the state and were taxable in the state. Thus, the court said that if the earnings were taxable in the state they could be subjected to a transfer tax. The following excerpts from the opinion in that case remove any question as to the basis of its decision:

> "* * * The basis of the instant tax is the fact that the dividends result from earnings from property situated or business transacted within this state. Such earnings are a proper subject of taxation, and therefore a proper basis for an excise tax on the transfer of the dividends resulting therefrom. * * *" (Pages 241-242)
>
> "* * * It is to be noted that the tax imposed on the salaries of nonresidents involved in the *Travis case, supra*, [*Travis v. Yale & Towne Mfg. Co.*, (1920) 252 U. S. 60, 64 L. ed. 460, 40 S. Ct. 228] was held not to impose a personal liability upon the nonresident employe. The tax, except as to a feature not involved herein, was upheld as a sequestration at their source of payment of earnings properly taxable which is precisely and only what the instant statute does." (Page 235)
>
> "* * * We perceive no more difficulty in taxing the transfer of dividends of foreign corporations attributable to business transacted or property situated within the state than in taxing such corporations on income so derived, and the validity of the latter form of taxation is established. The fact that the dividends involved are derived from earnings within the state gives them a constructive situs within the state. They

> are as readily collectible as is an income tax against a foreign corporation. Liability for payment of the tax is imposed upon the corporation. If such liability may be imposed there is no difficulty about collecting it, and there is no more difficulty about imposing the liability than existed in the *Travis Case, supra*, about imposing upon the employer liability for the income tax on salaries of nonresidents earned within the state." (Pages 245-246)

In its decisions in *J. C. Penney Co. v. Tax Comm.*, (1940) 233 Wis. 286, 289 N. W. 677; *F. W. Woolworth Co. v. Tax Comm.*, (1940) 233 Wis. 305, 289 N. W. 685; *Minnesota Mining & Mfg. Co. v. Tax Comm.*, (1940) 233 Wis. 306, 289 N. W. 686, the Supreme Court of Wisconsin adhered to its construction of the law as laid down in the *Froedtert* case. However, as stated in its opinion, it felt that the decision of this Court in *Connecticut Gen. L. Ins. Co. v. Johnson*, (1938) 303 U. S. 77, 58 S. Ct. 436, 82 L. ed. 673, necessitated the overruling of the view taken in the *Froedtert* case to the effect that the earning of income within the state furnished a basis for the imposition of the tax upon the transfer of that income from a corporation to a stockholder. Being of this view, the court felt that the tax could not be sustained under the Fourteenth Amendment and so held.

At the hearings upon *certiorari* before this Court we freely admitted that the state could not tax the privilege of transferring a dividend or the physical act of making the transfer if this privilege and this act were to be considered without relation to the earning of the income distributed and the benefit enjoyed of the protection of the law of Wisconsin in respect to the doing of business in Wisconsin. We claimed, however, that the decision of this Court in the *Froedtert* case was correct; that the derivation of earnings in this state by a corporation and the benefit enjoyed of the protection of the laws of Wisconsin entitled the state to tax the transfer of such earnings to

its stockholders *at the time of such transfer;* and that the *Connecticut General Life Ins. Co.* case should not be interpreted as holding to the contrary.

As we read the decision of this Court it bases the jurisdiction of the state to impose the privilege dividend tax upon precisely the same ground that the jurisdiction was rested in the *Froedtert* case, namely upon the jurisdiction to tax Wisconsin earnings and to measure a tax as payment for protection and enjoyment given by a state under its laws by the fruit thereof. This Court said in its opinion in the case, as the Supreme Court of Wisconsin said in the *Froedtert* case, that the State of Wisconsin possessed jurisdiction to tax the income or earnings of foreign corporations attributable to the transaction of business in the state. It said that if the present tax were to have been expressly denominated a tax on earnings, payable at the time of distributing such earnings, no court could have questioned the power of the state to levy such a tax.

From this premise it reasoned that the tax in practical operation subjected the transfer of Wisconsin earnings of foreign corporations to taxation and by reason of that fact was within the power of the state to impose the same.

The following passages from the court's opinion state the basis of its decision:

> "* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income a tax on corporate income that is paid out." (61 S. Ct. 248, 85 L. ed. 224.)

> "Had Wisconsin, as part of its price for the privileges it afforded foreign corporations within its borders, explicitly provided for a supplementary tax on the Wisconsin earnings of such corporations, but post-

poned liability for the tax until such earnings were to be paid out in dividends, the power of Wisconsin to do so would hardly be questioned. * * * Since the process for declaring dividends and the details attending their distribution among the stockholders transpired outside Wisconsin, although the exaction was apportioned to the earnings derived from Wisconsin, the state court concluded that the tax was an attempt by Wisconsin to levy an exaction on transactions beyond Wisconsin's borders.

"The case thus reduces itself to the inquiry whether Wisconsin has transgressed its taxing power because its supreme court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax on the privilege of declaring dividends rather than a supplementary income tax." (61 S. Ct. 249, 85 L. ed. 225)

"* * * That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. * * *"

"* * * Here, on the contrary, the incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible, in so far as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes. * * *" (61 S. Ct. 250, 85 L. ed. 226)

This language of this Court should be considered in relation to the statements of the Supreme Court of Wisconsin above set out to the effect that the privilege dividend tax in its practical operation is "a sequestration at

their source of payment of earnings properly taxable." We submit that the concept of jurisdiction to tax implied in the quoted statement in the *Froedtert* case cannot be fairly distinguished from the concept evidenced by the decision of this Court in *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267.

Moreover, aside from the language used in the *Froedtert* case, it must be evident that the basis of the jurisdiction to tax there asserted is the same as that which was found to exist by this Court. In the *Froedtert* case this Court held that the tax must be rested upon the jurisdiction of this state to tax the earnings transferred. In other words, it was the fact that the state had afforded protection in the acquisition, preservation and distribution of the income that permitted it to tax the distribution of that income. The earnings were regarded as having a situs in this state for purposes of taxation and the tax was regarded as falling upon said earnings at the time of distribution thereof.

It is thus seen that this Court did not hold the tax here in question to be an income tax, as that term is commonly understood. It only held, as the Supreme Court of Wisconsin had held before it in the *Froedtert* case, that for purposes of taxing jurisdiction under the Fourteenth Amendment the tax in its practical operation fell upon that which the state had jurisdiction to tax, namely, earnings derived from business transacted within its territorial jurisdiction. It will be noted that this Court used the words "income" and "earnings" interchangeably. If it had used the word "earnings" throughout its decision, it probably would not occur to anyone to say that the tax was held to be an income tax.

In *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186 (on remand) the Supreme Court of Wisconsin said at page 72:

"Inasmuch as the legislature expressly declared the tax to be for the "privilege of declaring and receiving dividends," we denominated it an excise or privilege tax. *State ex rel. Froedtert G. & M. Co. v. Tax Comm.* (1936) 221 Wis. 225, 233, 265 N. W. 672, 267, N. W. 52. We said:

"'However the legislature may have regarded the tax, we have no difficulty in construing the statute as imposing an excise or privilege tax upon the transaction involved of transferring the dividends from the corporation to its stockholders.'"

Further in said opinion it said at page 73:

"* * * we do not understand that the supreme court of the United States held the tax in question to be an income tax and sustained it as such. The supreme court of the United States said (p. 444):

"'These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. *The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders.* The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.'"

"We understand the court upon the whole case to hold that the state of Wisconsin has jurisdiction to levy the tax in question upon the 'privilege of declaring and receiving dividends' out of income earned within the state of Wisconsin even though the dividend is declared under the law of the state of Delaware or New York and the transaction of declaring the dividend took place within the state of New York where the disbursement was made.

> "The only question presented by the record on appeal to the supreme court of the United States was whether the state had jurisdiction to levy the tax. The supreme court of the United States was not asked to construe the statute. That is matter under the decisions of the supreme court of the United States which is clearly a function of this court, and we must assume that the supreme court of the United States made its decision in recognition of that fact. While we do not concur in the view of the supreme court of the United States as to jurisdiction, we are bound by its decision and yield to it upon the ground stated and upon no other."

To the extent there may be anything in the language used in the opinion in *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186, (upon remand) which appellants assert as supporting their thesis of conflict, it has been completely clarified and eliminated by the express language of the decision in *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169. The very same arguments that are made here were made to the Supreme Court of Wisconsin upon the argument before it in the cases of *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 169; *Minnesota Mining & Mfg. Co. v. Dept. of Taxation*, (1943) 243 Wis. 211, 10 N. W. (2) 174 and also in the cases *Wisconsin Gas & Electric Co. v. Dept. of Taxation*, (1943) 243 Wis. 216, 10 N. W. (2) 140; *Blied v. Wisconsin Foundry & Machine Co.*, (1943) 243 Wis. 221, 10 N. W. (2) 142. That court specifically addressed itself to the proposition and in *International Harvester Co. v. Dept. of Taxation*, (1943) 243 Wis. 198, 10 N. W. (2) 174, said in the unequivocal language previously quoted at pages 17 and 18 of this brief, that its basis of holding this law valid is the same as that upon which this Court sustained it in the prior cases. It would seem that this should be conclusive.

Moreover, there are considerations which precluded and presently prevent this tax law from being construed as having any different effect or operation than that which it was held to have in the decisions of the Supreme Court of Wisconsin in *State ex rel. Froedtert G. & M. Co. v. Tax Comm.*, (1936) 221 Wis. 225, 265 N. W. 672, 267 N. W. 52 and of this Court in *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267; *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274; *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395. As previously noted, under the heading "Statutes Involved," the Wisconsin Privilege Dividend Tax Law was enacted in 1935 and took effect upon its publication September 26, 1935. The decision of the Supreme Court of Wisconsin in the *Froedtert* case was on April 26, 1936. The decision of this Court in the *Penney* case was on December 16, 1940 and rehearing was denied January 13, 1941. The decision of the Supreme Court of Wisconsin in *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186 (upon remand) was on May 20, 1941.

The legislature of Wisconsin, because this tax law as originally enacted was effective only to July 1, 1937, in effect re-enacted it by Ch. 309 of the Laws of Wisconsin of 1937 (effective on its publication on June 30, 1937) extending its operation to July 1, 1939. It is irrefutable that in so doing the legislature of Wisconsin in re-enacting this statute intended to and did accept the interpretation and construction placed upon it by the Supreme Court of Wisconsin in the *Froedtert* case. In other words, the legislature had full cognizance and knowledge of the construction placed upon the law in the *Froedtert* case and yet re-enacted it, so far as here material, in the language of the original act. Such re-enactment in effect used said language as having the meaning, intent and effect which the court had given to it in the *Froedtert* case.

Under such circumstances such construction of the law is as much a part of it as if embodied therein in plain and unmistakable language. *Eau Claire National Bank v. Benson,* (1900) 106 Wis. 624, 627, 82 N. W. 604; *Milwaukee County v. City of Milwaukee,* (1933) 210 Wis. 336, 341, 246 N. W. 477. When a court has construed a statute that interpretation becomes as much a part of the statute as if written into it originally.

Once a statute has been construed by the court, the legislature by not amending it thereafter is deemed to have accepted the court's interpretation of the statute as a correct expression of the legislative intent.

Estate of Siljan, (1939) 233 Wis. 54, 59, 288 N. W. 775;

Evans v. Michelson, (1942) 241 Wis. 423, 426, 6 N. W. (2) 237.

The legislature of Wisconsin by Chapter 198 of the Laws of Wisconsin of 1939 (effective on its publication on June 30, 1939) again extended its operation to July 1, 1941 and thereby re-enacted this same statute, in so far as here material, the identical and original language of the law, and increased the rate from 2½% to 3%. It thus again in effect enacted a statute that can only have been intended to and did operate in precisely the way that the court in the *Froedtert* case had previously stated. Here again that language of the court in that decision became a part of this law just as much as though it had been written into the same. Accordingly, it is impossible to give any construction to that statute any different than that which was initially given to it by the Supreme Court of Wisconsin in *State ex rel. Froedtert G. & M. Co. v. Tax Comm.,* (1936) 221 Wis. 225, 265 N. W. 672, 267 N. W. 52.

But this is not all, the legislature of Wisconsin by Chapter 63 of the Laws of Wisconsin of 1941 (effective

on its publication April 30, 1941) again re-enacted this statute by extending its operation to July 1, 1943. This was subsequent to the decisions of the Supreme Court of Wisconsin in *J. C. Penney Co. v. Tax Comm.*, (1940) 233 Wis. 286, 289 N. W. 677; *F. W. Woolworth Co. v. Tax Comm.*, (1940) 233 Wis. 305, 289 N. W. 685; *Minnesota Mining & Mfg. Co. v. Tax Comm.*, (1940) 233 Wis. 306, 289 N. W. 686. By the same token, as so re-enacted such statute cannot be given any different interpretation than had prior thereto been given to it by the Supreme Court of Wisconsin in its prior decisions and by this Court in its decisions just mentioned.

Then finally, the legislature of Wisconsin by Chapter 365 of the Laws of Wisconsin of 1943 (effective on its publication June 30, 1943) again re-enacted this statute by extending its operation to July 1, 1945. This re-enactment was subsequent not only to the decisions of the Supreme Court of Wisconsin in the *Froedtert* and *Penney, et al.* cases and the decisions of this Court in the *Penney et al.* cases, but was also subsequent to the decision of the Supreme Court of Wisconsin in *J. C. Penney Co. v. Tax Comm.*, (1941) 238 Wis. 69, 298 N. W. 186 (upon remand. This re-enactment not only constitutes the adoption of this statute as intended to have the interpretation given to that language in the prior cases of the Supreme Court of Wisconsin and this Court prior to such re-enactment and incorporated it in the law just as effectively as if the language of the courts had been set forth therein, but also adoption of the construction given to it by the Supreme Court of Wisconsin in its opinion on remand specifying the surplus analysis method as the proper method to be used in computing the tax.

Due to the fact that some of the periods involved in the present appeal do not fall within all of the above extensions of this law by the legislature of Wisconsin it

is true that any extensions subsequent to such periods are not applicable. Nevertheless, this history of this tax law does show the legislative intent and demonstrates that had the legislature intended the statute to provide a tax different than as construed by the courts it obviously would have changed it to provide otherwise and as expressing what was its intention. As previously stated this tax law is a present operative part of the tax laws of the State of Wisconsin. The re-enactments thereof adopt the construction of the courts as an integral part of the statute the same as if written into it and it can only now be given that construction. It would indeed be most anomalous for the original taxing statute as enacted by Ch. 505, Laws of 1935 to be construed differently from the construction given to it by the Supreme Court of Wisconsin in the *Froedtert* case, and for the re-enactments of 1937, 1939 and 1941 should be given a different construction, or for there to be any variance in the construction of such re-enactments. Be that as it may, it is inescapable that the presently operative re-enactment of this statute was adopted with full cognizance of all the decisions of this Court and of the Supreme Court of Wisconsin in reference to this tax law, including the five cases decided by the Supreme Court of Wisconsin on June 16, 1943, of which the decision in the instant case was one, because Chapter 367 of the Laws of Wisconsin of 1943 was approved by the Governor of Wisconsin on June 29, 1943 and took effect upon its publication on June 30, 1943. Whatever may be said in reference to any of the other re-enactments it is submitted that it is inconceivable upon what basis it could be said that this present operative extension of this Wisconsin Tax Law does not incorporate in it as an integral part thereof, just as effectively as if written therein, the constructions and interpretations that have

been pronounced by this Court and the Supreme Court of Wisconsin.

As was said by the Supreme Court of Wisconsin in *Milwaukee County v. City of Milwaukee*, (1933) 210 Wis. 336, 342, 246 N. W. 447:

> "* * * Public officers had a right to rely upon the interpretation placed upon the statute by the court and acquiesced in by the legislature. *Assuming that the court has the power to reverse its former ruling*, it should not exercise it under the circumstances because it would unsettle governmental transactions now in process of being carried out entered upon in reliance upon it. * * *" (Emphasis supplied)

The obvious purpose of this tax law initially, and in all of its re-enactments, is to raise state revenue. In all of its re-enactments thereof the legislature relied upon the court decisions which were prior thereto and appraised its renewal thereof as a revenue producing measure in accordance with and in reliance upon those decisions. The legislature at those times was concerning itself with the fiscal affairs of the state and providing of such revenue measures as would produce the funds necessary to operate the state government. Even with the efficacy of the re-enactments of this tax law, appraised by the legislature in accordance with the interpretations placed upon it by the courts, it had to seek other and new fields of taxation and enacted various other new and additional tax measures in order to meet the state needs for revenue. It not only did, but certainly had a right to, rely upon this taxing measure as so construed and appraise it in the light thereof. Fiscal affairs of the state once settled under such circumstances must and should be maintained without danger of vacillation or uncertainty. The legislature in preparing the financial affairs of the state is entitled to accord finality to the decisions of the courts and to rely thereon in determining the future course of state affairs. This is the force of the

rule above stated that enactment or re-enactment of a statute under the above circumstances imports and incorporates into such taxing statute the interpretations placed thereon by the courts the same as if written therein in express language. Without this there cannot be any certainty to or continuity in the fiscal affairs of a state.

The concepts above set forth were somewhat recently expressed by this Court in *Newark Fire Ins. Co. v. State Board of Tax Appeals*, (1939) 307 U. S. 313, 323, 59 S. Ct. 918, 922, 83 L. ed. 1312, 1319, as follows:

> "Wise tax policy is one thing; constitutional prohibition quite another. The task of devising means for distributing the burdens of taxation equitably has always challenged the wisdom of the wisest financial statesmen. Never has this been more true than today when wealth has so largely become the capitalization of expectancies derived from a complicated network of human relations. The adjustment of such relationships, with due regard to the promotion of enterprise and to the fiscal needs of different governments with which these relations are entwined, is peculiarly a phase of empirical legislation. It belongs to that range of the experimental activities of government which should not be constrained by rigid and artificial legal concepts. Especially important is it to abstain from intervention within the autonomous area of the legislative taxing power where there is no claim of encroachment by the states upon powers granted to the national government. It is not for us to sit in judgment on attempts by the states to evolve fair tax policies. When a tax appropriately challenged before us is not found to be in plain violation of the Constitution our task is ended."

II. THIS COURT DID NOT HOLD THE TAX AN INCOME TAX AGAINST THE CORPORATION.

As previously stated in the preface ever since the decision of this Court in the prior cases, *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed.

267; *Wisconsin v. Minnesota Mining & Mfg. Co.*, (1940) 311 U. S. 452, 61 S. Ct. 253, 85 L. ed. 274; *Wisconsin v. F. W. Woolworth Co.*, (1940) 311 U. S. 622, 61 S. Ct. 395, 85 L. ed. 395, the appellants have persisted in misconstruing what was said by this Court in such decision by contending that the tax in question was there held to be an additional income tax against the corporation and sustained it solely as such. This is an entirely erroneous interpretation of such decisions. What this Court there said was responsive to the arguments that were being made in those cases and when it used the words "supplementary income tax" it was not intended thereby to characterize the tax as an income tax. Rather, such language was used in discussing the jurisdiction to impose the tax and upon what considerations the same was founded. It said that the same principles which support an income tax are applicable to and support this tax, namely, that it is an exaction by the State of Wisconsin commensurate with and for privileges, benefits and protection rendered by the State of Wisconsin and levied at the time of realization of the benefits thereof. It was not meant that this tax is an income tax but that it is supplementary to the income tax and that the same fundamental principles are applicable to both.

The Court there said that if the State of Wisconsin had explicitly imposed an income tax, in addition to its regular income tax, on the earnings of corporations doing business in the state and derived from such business but postponed liability therefor until such earnings were paid out by way of dividends there could be no possibility of questioning jurisdiction to impose such a tax. It then said further that the fact that the State of Wisconsin has not couched the statute imposing this tax in language specifically exacting it as a price for the privilege of doing business in Wisconsin did not preclude this tax, whose operating incidents is to the same effect, from being a valid tax.

Such tax being imposed at the time of the distribution of the benefits realized from the doing of business in Wisconsin it was held that there is a fiscal relationship between the tax and the protection, opportunities and benefits given by the state in connection with enjoyment of the substantial privilege of carrying on business within its borders. Such protection exists not only in connection with the earning of the income in Wisconsin, distribution of which is the measure of the tax, but as well in the preservation of the property and business of the corporation in the state.

In other words, this Court did not say that this tax is an income tax but merely that jurisdiction to impose it is the same as that which is invoked in imposing an income tax and that merely because it is not labeled or imposed as an income tax does not destroy or deny the existence of basic jurisdiction to impose it which is rested upon benefits conferred, where the tax is measured by, geared to and imposed at the time of the realization of the fruits of such benefits and commensurate therewith.

The cases cited by this Court in its opinion adequately support this position set out therein.

III. THE SUPREME COURT OF WISCONSIN DID NOT HOLD THE TAX IS IMPOSED UPON THE STOCKHOLDER.

In support of their assertion that this tax has been "construed" by the Supreme Court of Wisconsin as a tax upon the stockholder, the appellants cite *Wisconsin Gas & Electric Co. v. Dept. of Taxation,* (1943) 243 Wis. 216, 10 N. W. (2) 104; *Blied v. Wisconsin Foundry & Machine Co.,* (1943) 243 Wis. 221, 10 N. W. (2) 142. Neither of these cases are to that effect.

In the first place the provisions of this tax law clearly provide that the corporation may deduct the tax from the

dividends paid to stockholders. The court thus did not and was not required to construe the statute, but merely gave effect to and applied the express provisions of it.

In the next place, all that the court decided in *Wisconsin Gas & Electric Co. v. Dept. of Taxation*, (1943) 243 Wis. 216, 10 N. W. (2) 140, was that because the Privilege Dividend Tax Law contained the provision it permitted the *burden* of the tax to fall *directly* on the stockholder and therefore the tax did not meet the qualifications specified in the provisions of sec. 71.03 (4) of the Wisconsin Income Tax statutes that in reporting its net income taxable in Wisconsin a corporation may deduct "taxes * * * paid during the year upon the property or business from which the income hereby taxed is derived * * *." What the court there held was that perforce of the deductibility provision of the Privilege Dividend Tax Law it was thereby shown that the privilege dividend tax was not imposed and did not fall as a burden on either the property of the corporation or the business activities of the corporation that produced the income taxed in that year—in other words, that the privilege dividend tax fell as a burden upon other than the corporation's income producing activities of that year.

The case of *Blied v. Wisconsin Foundry & Machine Co.*, (1943) 243 Wis. 221; 10 N. W. (2) 142 holds nothing more than that as applied to Wisconsin resident stockholders receiving dividends from Wisconsin corporations out of earnings in Wisconsin the deductibility provisions in the Privilege Dividend Tax Law are valid. Actually there is no basis for challenging the validity thereof and none was asserted in that case, excepting the claim that this Court had held the tax to be an income tax upon the corporation, and therefore it could not be deducted from the dividend remitted to the stockholder. All the court said in that case was that the Privilege Dividend Tax Law

expressly provides that the corporation could so deduct it and such provision is valid. If support be needed for this conclusion Section 1 of Article XI of the Wisconsin Constitution expressly provides:

> "SECTION 1. Corporations without banking powers or privileges may be formed under general laws, but shall not be created by special act, except for municipal purposes, and in cases where, in the judgment of the legislature, the objects of the corporation cannot be attained under general laws. All general laws or special acts enacted under the provisions of this section may be altered or repealed by the legislature at any time after their passage."

and it has been held that rights of corporations and their stockholders are subject to the powers of the state to make changes in its laws as applied to them under this reserve power. *Johnson v. Bradley Knitting Co.*, (1938) 228 Wis. 566, 280 N. W. 688.

In this connection it is desired to note that the Brief for the United States in case No. 565, October Term, 1943, entitled *Wisconsin Gas & Electric Company v. United States of America*, at the top of page 20, erroneously sets out that the Supreme Court of Wisconsin at page 219 of its decision in *Wisconsin Gas & Electric Co. v. Dept. of Taxation*, (1943) 243 Wis. 216, 10 N. W. (2) 140, said that the controlling question in that case was:

> "Whether this is a tax upon the corporation, in which case it is assumed that it must be regarded as an expense of doing business deductible from gross income, or whether it is a tax upon the stockholders."

This makes it appear that the Supreme Court of Wisconsin said that if the tax were to be held by it to be a tax on the corporation then it would have to be regarded as a deductible expense, from which it is inferred that if it had held the tax to be upon the stockholder its decision necessarily would have been directly contrary to the one which it reached. Actually the Supreme Court of Wisconsin did

not say that such was the question nor did it make such inference. The above is not a quotation of the complete language of the court at that point in its opinion. In using the language that is quoted the Supreme Court of Wisconsin was merely saying that such was the contention of the appellant Wisconsin Gas & Electric Co. in that case and that in making such contention the appellant made the stated assumption. The full quotation is as follows:

> "We are favored with able briefs addressed to the question whether this is a tax upon the corporation, in which case it is assumed that it must be regarded as an expense of doing business deductible from gross income, or whether it is a tax upon the stockholder. We are not at all sure that all of this argument does not (to paraphrase the opinion of the United States supreme court in the *Penney Case, supra*) amount to glossing over the provisions of the statute with commentary and then construing the commentary rather than the text. The real question in this case is: On whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends, and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the supreme court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the United States supreme court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend. At this stage of the litigation we are not concerned with the question of the power

to tax and we must assume that the power vindicated is the power to levy the very tax that was before the United States supreme court for consideration. That power having been sustained, regardless of what the tax be called or where its burdens may be considered to fall, it is immaterial that the United States supreme court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. * * *"

Finally, the provisions of this law impose the tax upon the corporation. Liability for payment of the tax is placed squarely and solely upon the corporation. There is nothing in the Privilege Dividend Tax Law which compels the corporation to deduct the tax or imposing any penalty if it does not do so, and consistent administration of this law is and has been to that effect. The liability to the state for the tax is imposed upon the corporation. Whether it deducts the tax or not makes no difference as to its liability. It is the same in either case. If it deducts the tax and does not pay it over to the state the penalties for not doing so are the same as where it does not deduct the tax but absorbs it and does not pay it. There is no personal liability on the stockholder. If after deducting the tax and before the state asserts the tax the corporation's assets should be so dissipated or lost so the state could not collect the tax there can be no recourse against the stockholders for the tax. The same is true if the corporation had not deducted the tax at all from the dividends.

Whether the tax is deducted from the dividend paid by the corporation or not deducted therefrom, the burden of the tax falls on the stockholder. Not being a deductible expense of the corporation it is necessarily chargeable to and operates to reduce the surplus. By deduction from the dividend the burden falls *directly* on the stockholder, whereas in the other instance it falls indirectly on him by reducing the surplus or what would be the surplus avail

able for future dividends. In one instance the dividend is smaller and in the other the fund for potential dividends is reduced by the same amount. The net effect is the same.

In this connection it is to be noted that the tax is imposed at the time the dividend is declared and paid. It is conceded that if the corporation is not doing business at that time in the state then no tax is imposed and the consistent administration of the law has been to that effect. This shows that the imposition of the tax is geared to the doing of business in the state at the time the dividend is declared and paid and that it is directly related to the utilization of the fruits derived from doing business in the state and the receipt thereof by those beneficially exercising the same.

It is pointed out by the Supreme Court of Wisconsin in its decision in the instant cases that this deductibility feature of this tax law was in it and a part of it at the time when this Court considered and declared it valid in prior cases. In fact such provision was expressly called to the court's attention and made the basis of an argument at page 14 of the brief of the Respondent J. C. Penney Company in support of its Petition for Rehearing which was denied by this Court January 13, 1941 in *Wisconsin v. J. C. Penney Co.*, (1940) 311 U. S. 435, 61 S. Ct. 246, 85 L. ed. 267.

However, in any event, the validity or invalidity of the provision for deduction by the corporation from the dividend payments to stockholders in no way affects the liability of the corporation for the tax which is imposed. The express provisions of the Privilege Dividend Tax Law very clearly make the corporation liable for the tax. Whether or not it may in turn pass that liability on to the stockholders is purely a matter between them. In the *Froedtert* case the Supreme Court of Wisconsin held that this provision was valid. But, even if it were invalid the separa-

bility provision of Section 4 of the original enactment, Chapter 505 of the Laws of Wisconsin of 1935, would be operative and these provisions for deduction of the tax could be eliminated without in any way offending or affecting the validity of the remainder of the tax law.

IV. THE TAX IS CLEARLY WITHIN THE TAXING JURISDICTION OF THE STATE OF WISCONSIN.

The basic and fundamental considerations by which a tax is tested as to whether it is within the taxing jurisdiction of a state are well settled. The court is not concerned with the labels or nomenclature used or applied to the tax, but only with the practical operation of the tax. If the practical operation of the tax is that the state has thereby imposed an exaction in relation to opportunities which it has given, to protection which it has afforded, or benefits which it has conferred, and commensurate therewith, then the tax is within its taxing jurisdiction and therefore is not violative of the due process provisions of the Fourteenth Amendment. *Lawrence v. State Tax Comm.*, (1932) 286 U. S. 276, 280, 52 S. Ct. 556, 76 L. ed. 1102; *Senior v. Braden*, (1935) 295 U. S. 422, 55 S. Ct. 800, 79 L. ed. 1520.

Upon these principles, as an original proposition, the decision in *State ex rel. Froedtert G. & M. Co. vs Tax Comm.*; (1936) 221 Wis. 225, 265 N. W. 672, 267 N. W. 52 is sound. The tax is clearly within the taxing jurisdiction of Wisconsin and therefore there can be no denial of due process. A license tax imposed upon a corporation and measured by its earnings would certainly be within the taxing jurisdiction of the state if the state had jurisdiction to tax the corporate earnings. So far as taxing jurisdiction is concerned, however, unless the state had jurisdiction to tax the earnings, it could not impose a license tax

measured by the earnings. The practical operation and effect of the tax would result in a tax measured by corporate earnings and the power to impose such a tax would be based upon the power to tax the corporate earnings.

And so in the case of a transfer tax upon property. A state possessing the power to impose a tax upon property can impose a tax upon the transfer of that property resulting from the death of the owner.

Rhode Island Hospital Trust Co. v. Doughton. (1926) 270 U. S. 69, 46 S. Ct. 256, 70 L. ed. 475.

The jurisdiction to impose a transfer tax in such a case arises out of the fact that the state has jurisdiction to tax the property. The state, in protecting the acquisition, preservation and enjoyment of property, acquires the right to tax such property. For the same reason it may tax its transfer.

To sum up, it may be said that the privilege dividend tax is based upon precisely the same jurisdiction as is an income tax, namely, the right to tax corporate earnings which are earned under the protection of the State of Wisconsin. Unlike the ordinary income tax, however, it is not imposed upon the privilege of receiving the income, but rather it is imposed upon the transfer of the income from the corporation to its stockholders. The substance of the decision in the *Froedtert* case and of this Court is that if the state can tax the earnings of a corporation it makes no difference, for purposes of due process, whether the earnings are taxed upon the basis of their acquisition or upon the basis of their distribution by a corporation to its stockholders.

The appellants, notwithstanding the decisions of this Court and the Supreme Court of Wisconsin, continue to assert that there is no reasonable relation between protection afforded in the acquisition of corporate earnings and the preservation thereof, and a tax imposed upon the dis-

tribution of such earnings. This contention is palpably unsound, and the court could hardly find otherwise.

The payment of a dividend by a corporation is the culmination of a series of events, namely, (1) conduct of business resulting in earnings, (2) keeping and conserving the property of the corporation, which includes its surplus made up of earnings until used to pay the dividend, (3) formal act of declaration, (4) physical act of payment by the corporation, and (5) physical act of receipt by the stockholders. The first two are the foundation for the others and without which they could not take place. The fact that the last three may have taken place outside of the state does not destroy the fact that the various steps in the series must be considered as constituting one integrated and indivisible transaction—a transfer of the benefits resulting from the doing of business in the state. *Van Dyke v. Tax Comm.*, (1940) 235 Wis. 128, 135, 292 N. W. 313; *Ford Motor Co. v. Beuchamp*, (1940) 308 U. S. 331, 60 S. Ct. 273, 83 L. ed. 1031. It is by reason of having given benefits in respect to the earning of the income and the preservation thereof (indispensable elements in the series) that the State of Wisconsin has impregnable jurisdiction. The tax here involved is measured only by so much of the dividends declared as have been the result of the benefits conferred by the State of Wisconsin and its laws in connection with the two first elements. The taxable event is the composite of the last three elements, but it is not these events nor the doing thereof that are taxed, but it is the transfer that is completed by them. The jurisdiction of a state is as broad as the protection afforded and conferred by the state.

The object of the corporate form of enterprise is to do business in a form thought to be suited to the profitable transaction of business—to acquire earnings—to preserve the same—and to distribute such earnings among the mem-

bers of the corporation. The corporation itself is an artificial entity distinct from its members and exists for the purpose of transacting business and acquiring earnings but it is in the very nature of things incapable of enjoying its earnings. It is of the very essence of a corporate business enterprise that its earnings shall inure to the benefit of its members and that only its members shall enjoy its earnings.

Thus, protection of the law of a state in which a corporation does business is invoked and given for the purpose of making it possible to earn income for distribution to the members of the corporation and in preserving and protecting the same until so distributed. The protection so invoked and given cannot, therefore, be dissociated from the distribution of corporate earnings. Corporate income is earned for the purpose of distribution to the corporate members and the state protects the acquisition of corporate income and the preservation of the corporation's property and business in order that there may be earnings to distribute to the members.

There can be no doubt that the ultimate distribution of the fruits or profits from corporate business to its stockholders is the prime, if not the sole, objective of corporate enterprise. Thus, a tax upon the transfer of corporate earnings derived from business transacted in the taxing state, is laid upon the benefits arising out of the exercise of rights under and protected by the laws of the taxing state. It taxes such benefits at the time they are realized by the very persons for whom they were earned and by whom, at the time of earning, it was intended they would be realized.

The appellants have claimed that the tax is a tax upon the privilege of transferring dividends—that the state does not grant this privilege in the case of foreign corporations, and that, consequently, the state cannot exercise the priv-

ilege. This argument overlooks the real basis of Courts' position. In the *Froedtert* case the court specifically held that the word "privilege," as used in relation to the transfer here involved, was to be understood as equivalent to the word "right." Many taxes were referred to as being classified under the name of privilege taxes and which in fact involve a tax upon the exercise of rights.

An inheritance tax or death duty is commonly referred to as a tax upon the privilege of transferring property to the living from the dead. On the other hand a state may tax such a transfer notwithstanding the fact that it does not grant the privilege and may not regulate the privilege. This must necessarily be so, since if it were otherwise the federal government could not impose a transfer tax.

Snyder v. Bettman, (1903) 190 U. S. 249, 23 S. Ct. 803, 47 L. ed. 1035;

Knowlton v. Moore, (1900) 178 U. S. 41, 20 S. Ct. 747, 44 L. ed. 969.

Jurisdiction to tax the subject matter of a transfer is held to result in jurisdiction to tax the transfer.

Graves v. Elliott, (1939) 307 U. S. 383, 59 S. Ct. 913, 83 L. ed. 1356;

Curry v. McCanless, (1939) 307 U. S. 357, 59 S. Ct. 900, 83 L. ed. 1339;

Rhode Island Hospital Trust Co. v. Doughton, (1926) 270 U. S. 69, 46 S. Ct. 256, 70 L. ed. 475;

Snyder v. Bettman, (1903) 190 U. S. 249, 23 S. Ct. 803, 47 L. ed. 1035.

This is precisely the basis of the tax here involved as we have already indicated.

The appellants have also contended that the transfer is effectuated by acts without the state and consequently it is beyond the taxing jurisdiction of the state. This Court in the prior case denied the soundness of such a

contention. Its soundness has been denied likewise by other decisions of this Court. Cases dealing with inheritance taxes have sustained the power of a state to impose a transfer tax in cases where no physical act effectuating the transfer took place within the territorial jurisdiction of the state.

Graves v. Elliott, (1939) 307 U. S. 383, 59 S. Ct. 913, 83 L. ed. 1356;

Bullen v. Wisconsin, (1916) 240 U. S. 625, 36 S. Ct. 473, 60 L. ed. 830;

Van Dyke v. Tax Comm., (1940) 235 Wis. 128, 135, 292 N. W. 313;

Estate of Bullen, (1910) 143 Wis. 512, 128 N. W. 109.

The distribution or transfer that gives rise to the tax is a distribution of *accumulated* corporate earnings. There can be no doubt but that corporations acquire earnings or profits. The ordinary dividend declared by a corporation, so far as an income tax upon the stockholders receiving the dividend is concerned, is regarded as having been declared *out of earnings or profits*. Such a dividend is a distribution of corporate earnings.

Van Dyke v. Milwaukee, (1915) 159 Wis. 460, 146 N. W. 812, 150 N. W. 509.

A liquidating dividend, so far as the stockholder is concerned, of course, would be in an entirely different category to the extent that it represented a distribution of paid-in capital.

A corporation or an individual earning income may use the fruits of earnings for many purposes. The entire fruits of its earnings for a particular year may be paid out for operating expense. It has, nevertheless, derived earnings. Corporate earnings may be used during the year for the purchase of capital goods. They may be used for the pur-

chase of government bonds or they may be placed in a bank. For purposes of income taxation as against a corporation a tax is customarily imposed at the end of a calendar or fiscal year, as the case may be, upon its earnings during such preceding calendar or fiscal year. At the time that the tax is payable the earnings may have become a part of the corporate surplus, but the fact remains that the corporation has acquired earnings and may be taxed upon the basis of having acquired earnings.

So in the case of the privilege dividend tax. If the tax were expressly denominated as a kind of income tax directed against such part of a corporation's earnings as are paid out in dividends, being necessarily those earnings which have been accumulated, and payable at the time of such distribution, there could be no constitutional objection to the tax from the standpoint of jurisdiction.

The jurisdiction to impose the tax upon foreign corporations is derived from the power to extract from corporate enterprises an exaction measured by Wisconsin earnings distributed to stockholders in the form of dividends. The power to impose this exaction arises by reason of the protection that the state affords in the acquisition of earnings that are distributed and the protection thereof until so distributed. A tax law which imposes a tax upon the distribution of accumulated earnings in return for the protection given by the state in the process of acquiring and accumulating such earnings and in rendering protection in the preservation thereof and the property represented thereby, is a reasonable form of taxation and is nonetheless within the power of the state because one may choose to term accumulated earnings as capital. Appellants presuppose that there may be no tax upon the distribution of capital,—which is not a justifiable assumption. The instances in which excise taxes are imposed upon transfers of capital, such as inheritance and gift taxes,

are numerous and their validity is well recognized and beyond question.

In connection with any contention that the subject which is taxed is not an activity that has a real and substantial relationship to business transacted in Wisconsin or that the state has granted the benefit only in the years in which the accumulated income that has gone into surplus was earned, it is to be noted that protection and benefit of the laws of the State of Wisconsin has not only been afforded to the corporation in the years of earning of that income but just as effectively in the years of declaration and payment of the dividends therefrom. In the dissenting opinion of Justice Roberts it is acknowledged that income earned in Wisconsin and accumulated may be employed in subsequent years in the extension of the company's business or may be held as assurance against future business loss.

The surplus which is made up of such accumulated funds is not represented by any particular property. Surplus is a mere bookkeeping concept. It is the excess of property (assets) generally over the obligations and capital of the company. To the extent that the corporation does business while it has such surplus, any state in which it does business confers, during that particular year, the benefits of its government and the protection of its laws in the use of such funds in the extension of its business, and in the preservation and the protection of its then present business and properties. Such business and properties so conducted in the state utilize and encompass a proportionate share of the surplus and have a direct bearing thereon. If the business activities and the properties of the corporation in the state were not protected and given the benefit of the laws of the state during the year in which the dividend is declared and paid, such proportionate share of the surplus, or even the whole surplus of the

company might be entirely dissipated. Conditions might even be so adverse as to cut into capital.

Any idea that a state rendering benefits to a foreign corporation in doing business in such state under the protection and benefits of its laws is limited by some concept of *quid pro quo* of license fees or taxes, imposed during the time when business was successful in the state and earnings were acquired and accumulated, is most unrealistic. A corporation might do business in a state for a number of years successfully and pay out none of its net income from activities in the state, but accumulate them and hold them in surplus. That the state, instead of increasing the income taxes imposed by it on such net income during the years in which it was earned, deems it more fair to wait until the fruits of doing business are no longer deemed necessary for expansion or as a financial cushion of the corporation and are paid out to the ultimate beneficiary, does not mean that in the subsequent years during which the corporation may have continued to do business in the state, it has not rendered protection and benefit to the corporation in the preservation and protection of its properties during the continuation of doing business in the state.

The benefits which flow from a state government and are enjoyed by those who operate under its protection at any particular time, or during any particular period of time, are not the result solely of expenditures by the state at such time or during such period. Such government, both physically and as an organization, has been built up through expenditures and efforts of the state over a long period of time. The enjoyment of the benefits of state government cannot be measured on a *quid pro quo* basis of expenditures or cost during that particular period. To do so would require a system of cost accounting which is not applicable to government.

Fiscal affairs of a state are solely upon an operating expenditure basis. Development of the governmental system generally is financed by expenditure over the years. Likewise things that are now done, which may call for large present expenditures, may, within our concept of government, be spread into the future and be borne by those who at that time will also partake of the benefits in the future of what may be done now.

Even if this were a tax on the stockholders there is nothing in the Constitution which precludes a state legislature, that permits corporations foreign and domestic to do business within the state, in the imposing of taxes on fruits thereof from looking through the corporate entity and imposing the tax upon the real beneficiaries when and as they realize such fruits and who enjoy such benefits in the precise amount by which the tax is measured.

If a state cannot impose an income tax on nonresident stockholders for dividends paid by corporations doing business in that state out of earnings derived therefrom the sole reason it cannot is because an income tax is imposed only upon the *receipt* of income. Here the tax is on the transfer and is placed on the corporation which is the only one made liable for the tax.

The foregoing propositions support this whether it be viewed as a tax upon the corporation or as a tax upon the stockholders. For present purposes it makes no difference upon whom the tax is imposed for the burden falls, directly or indirectly, upon him who has enjoyed the benefits conferred by the state and at the time of his realization of the fruits thereof. Giving effect to substance and disregarding form, the practical operation of the tax, regardless of its label or name, upon whom it is directly laid, or where the burden of it falls, is the imposition by the state of a compensatory tax. *Biddle v. Commr.*, (1938) 302 U. S. 573, 58 S. Ct. 379, 82 L. ed. 431; *Barnes v. Railroad*,

(1873) 17 Wall. (84 U. S.) 294, 21 L. ed. 544; *Bailey v. N. Y. C. & H. R. R. Co.*, (1875) 22 Wall. (89 U. S.) 604, 22 L. ed. 840; *Railroad Co. v. Collector*, (1879) X Otto (100 U. S.) 595, 25 L. ed. 647.

V. THE PRIVILEGE DIVIDEND TAX IS NOT A RETROACTIVE TAX.

Appellants urge that because the surplus is made up of accumulated income of past years the tax cannot be measured by any portion of a dividend that represents a distribution of earnings accumulated prior to the enactment of this tax law, because to do so would be invalid for retroactivity. This completely overlooks the fact that the tax is imposed at the time the transfer takes place and does not operate retroactively to tax anything that has gone on or taken place prior thereto.

This tax is not a retroactive tax. It does not impose an income tax on the receipt of income in the past. It imposes the tax in the year in which the dividend is declared and paid—a present occurring transaction. The fact that if a corporation is not doing business in the state when a dividend is declared and paid, no tax is imposed in that case, shows this very clearly.

Even if it were subject to the same considerations as an income tax in this regard, it is no more retroactive in its operation and effect than the taxation of a capital gain in the year of sale, when a profit or gain results from an increment over the years since its purchase in a past year. The tax is merely measured by the accumulated income that is used to pay the dividend and which as between the parties to the transfer is still income and used as such. The tax attaches upon the distribution and is measured by it. It measures the benefit received by the amount of realization from it and is fair as the monetary equivalent thereof.

If a state can tax the capital used in doing business within its borders notwithstanding it may have been accumulated in years prior to the tax, it certainly levies the tax for the utilization thereof in such years. Then, it would seem clear that it may measure that utilization by the amount realized therefrom and impose a tax using such measure. That is the precise situation here and there can be no suggestion that this is retroactive taxation.

Here under *Welch v. Henry*, (1937) 223 Wis. 319, 271 N. W. 68, 226 Wis. 595, 277 N. W. 183, affirmed 305 U. S. 134, 59 S. Ct. 121, 83 L. ed. 87, the legislature could have made this tax law impose the tax on all dividends declared paid during the prior year 1934, in which event then the tax would have been truly a retroactive tax. It would then have imposed a tax back upon something which took place prior to its enactment. But, under that case it would have clearly been valid. Such mechanics of the tax are entirely different from those of the instant tax. Here the tax is imposed upon the occurrence of a presently occurring event.

The tax is no more retroactive than the Federal tax on undistributed profits or in fact than any transfer tax. The instant tax is wholly unlike the tax in *Welch v. Henry, supra*. There the legislature admittedly, *in a year* subsequent to the year in which income was realized and received, imposed a retroactive tax thereon as *income*. It imposed a tax *in a year subsequent* to the year in which income was received, upon *income* received in a prior year, which at the time of its receipt was specifically exempted from being taxed as income. Here, however, the tax is imposed upon a present act or occurrence which takes place during the tax year. The distinction seems well illustrated by the following quotations from the dissenting opinion of Justice Fairchild in *Welch v. Henry, supra*, where he said:

"* * * It seems to me that the limits of the powers conferred upon the legislature by the people have been exceeded in this particular. It has never been considered fair play to impose burdens or penalties by *later legislation* upon a fellow citizen for *an act or transaction* which was lawful at the time of its occurrence, and the power to do that was withheld from governmental agencies by the people. * * *" (Page 336) (Emphasis ours)

"Apart from the quoted remark in the *Stockdale Case*, there is no authority for holding that after *an income tax on income received during a given year* has been assessed and collected, the legislature may constitutionally tax the income received that year to a further extent. Fairness suggests that when a taxpayer's tax on one year's income has been assessed and paid according to the law then in force, the taxpayer is justified in concluding that the matter is closed except for fraud or erroneous assessment. * * *" (Page 339) (Emphasis ours)

"* * * Laws relating *to acts and events to occur in the future are acceptable* and may be justified in taxation under the fundamental policy of protecting the rights of all and preserving the integrity of the government, but impositions on closed transactions cannot long be tolerated in a free government. Mr. Justice STORY in the case of *Society for the Propagation of the Gospel v. Wheeler*, Fed. Cas. No. 13,156, 2 Gall. *105, 139, defined a retroactive or, as he called it, a retrospective law:

"'Upon principle, every statute, which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, *in respect to transactions or considerations already passed*, must be deemed retrospective.'" (Page 340) (Emphasis ours)

Thus, viewed as a tax on the corporation it is not retroactive. On the other hand even if it were a tax upon the stockholder, then clearly it is not retroactive.

In *Van Dyke v. Milwaukee*, (1916) 159 Wis. 460, 146 N. W. 812, the Supreme Court of Wisconsin answered the question as to whether dividends declared and distributed

during 1911 by a going corporation out of surplus on hand prior to January 1, 1911, when the income tax law went into effect, were taxable as income for 1911? It held that an affirmative answer must be given to this question because the plaintiff, a stockholder in the corporation, received income during 1911 and said at page 465:

> "*It was immaterial when it was earned by the corporation.* As a stockholder he [taxpayer] acquired no right to it until it was distributed in the form of a dividend. The profits of a corporation become income to stockholders when distributed as dividends but not before." (Five cases cited.)

To paraphrase the holding of the court in the *Van Dyke* case, the dividends there taxed were received by the stockholder in the year in which the assessment was made and so far as he is concerned he received no income until distribution was made as a dividend. The dividend was *to him* income of the year he received the dividend, which is the same year the tax is assessed. Hence, no Wisconsin earnings can be said to be taxed in any sense of the word, but a dividend is being taxed in the year of its distribution. —clearly not retroactive taxation. The *Van Dyke* case was followed in *State ex rel. Sallie F. Moon v. Tax Commission,* (1917) 166 Wis. 287, 163 N. W. 639, where the court said on page 289:

> "The fact that it [a dividend] was received during 1911 makes it taxable irrespective of when it arose or accrued. That such provisions of the law do not render it void was held in the income tax cases. . . . This surplus was not income to the . . . company but it was to its stockholders when distributed."

The dividends paid to a stockholder even though out of surplus accumulated prior to the enactment of the law was not the taxation of earnings to the corporation but the taxation of a dividend received in the assessing year by the stockholder and the corporation was simply made liable

for its collections. Mr. Chief Justice Winslow, in this *Sallie F. Moon* case, expressed the proposition in a very simple and direct manner in the following language at page 293:

> "Suppose A. had property worth $10,000 in hand at the time the Income Tax Law went into effect and disposed of it a year later for exactly $10,000, he has received no income, but if he conveys it to B. as compensation for services, B. has clearly received an income and is subject to an income tax.
>
> "A corporation is one person, a stockholder in the corporation is a different person. Undivided profits in the treasury of the corporation belong to the corporation, not to the stockholder. They may be lost or squandered or put into improvements of the corporation property and never come to the hands of the stockholders. Such profits which were in existence at the time the Income Tax Law went into effect remain property so far as the corporation is concerned and in no sense income received by the corporation; but when dividends are declared out of them, such dividends become in every proper sense income in the hands of the stockholders.
>
> "For these reasons we perceive no conflict between the two decisions."

The three members of the Supreme Court of Wisconsin taking the view that the tax is retroactive said the case should be decided on the analogy to the income tax cases. Hence, even based upon their own theory, there is no retroactivity since none of the dividends are income to the individual stockholder until declared and paid to him, which admittedly takes place in the year in which the privilege dividend tax is imposed.

In *Morgan v. Tax Comm.*, (1928) 195 Wis. 405, 217 N. W. 407, 218 N. W. 810, a distribution to stockholders of profits in part earned prior to the effective date of the income tax law was again held taxable as income when distributed and not bad for retroactivity. See especially the opinion on rehearing at page 409.

In *Falk v. Tax Comm.*, (1935) 218 Wis. 130, 134, 259 N. W. 624, the court makes very clear its adherence to the *Van Dyke* case by pointing out that it took a change in the income tax law through Chapter 247 of the Laws of 1917 to prevent the taxation of dividends, distributions by a corporation out of earnings or profits accrued prior to the effective date of the law.

The dividend tax situation is much stronger than any of the income tax cases cited because the dividend tax has been held to be a privilege or excise tax on a transaction, which transaction admittedly takes place in the assessing year, whereas in the cases cited the tax was on income admittedly earned prior to the effective date of the income tax law. How then, in the face of these decisions can the viw of retroactivity be sustained?

In the *Income Tax Cases*, (1912) 148 Wis. 456, 514, 134 N. W. 673, the court saw no problem and said briefly:

> "One further objection we overrule here without comment, for the reason that it seems very unsubstantial, namely, the objection that the law is retroactive and void, because assessed on incomes received during the entire year 1911, while it did not go into effect until July 15th of that year, and also because it includes profits derived from the sale of property purchased at any time within three years previously."

The privilege dividend tax is not a tax on corporate earnings but on the privilege of, *first*, the *declaration* of a dividend out of earnings, which exercise of privilege takes place in the year in which the tax is assessed and hence is never retroactive, and *secondly*, upon the privilege of *receiving dividends* by stockholders out of corporate earnings having their roots in Wisconsin business or property the receipt of which likewise takes place in the year which is always the year in which the tax is assessed, and hence not retroactive. It is because of the above and because the court holds the tax to be a privilege tax (not an income

tax), the burden of which is borne by the stockholder, that *Van Dyke v. Milwaukee*, (1916) 159 Wis. 460, 146 N. W. 812, is here controlling, rather than such cases as *Welch v. Henry*, (1937) 223 Wis. 319, 271 N. W. 68, 226 Wis. 595, 277 N. W. 183, affirmed 305 U. S. 134, 59 S. Ct. 121, 83 L. ed. 87, which limit the extent to which *"earnings"* of an *individual* may be taxed.

In *Welch v. Henry, supra*, in an opinion written by the learned justice who wrote the opinion in *International Harvester Co. v. Wisconsin Dept. of Taxation*, on the instant cases, the court was undoubtedly greatly influenced by factors not present in this case. There the dividend income sought to be taxed was once *expressly* exempt from taxation and that type of retroactive taxation which reaches back beyond a maximum of two years is indeed distasteful and unfair, but here no such considerations are present. Here the tax is laid upon a transaction within thirty days after the act giving rise to the right to tax takes place. The taxpayer is not taxed on *income* received two years prior to the assessment as was in *Welch v. Henry, supra*, but is taxed the instant the corporate earnings are distributed. From the standpoint of the burden of the tax falling on the stockholder nothing need by done by him—his corporation withholds and pays the tax. He had no right to the surplus until his corporation made the surplus available to him in the form of dividends.

Arguments founded upon asserted unfairness of this tax because the corporation had no opportunity to avoid it because not anticipated are without merit. It could have declared and paid dividends to the full extent of its surplus had it desired to do so during the time this tax law was pending in the legislature. Furthermore, it does not have to continue to do business in the state and is free to withdraw therefrom. As previously pointed out should

it do so then it would not be subject to this tax when and if it pays dividends.

Scattered through the Brief of Appellant in Case No. 620, in which the International Harvester Company is appellant, there are references to details in the computation of the taxes here involved and, if not actually then inferentially, complaining in respect thereto. To the extent any such arguments relate to the details of computation they are foreclosed by and contrary to the stipulation entered by counsel for appellant (Case No. 620, R. 30-31) and should be disregarded.

CONCLUSION

It is respectfully submitted that the tax law in question has not been shown to be and is not violative of the Fourteenth Amendment to the Constitution of the United States, and that the decisions of the Supreme Court of Wisconsin affirming the tax here involved should be affirmed.

Respectfully submitted,

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APPENDIX

The Wisconsin statutory tax law here involved, enacted by Chapter 505, Laws of Wisconsin of 1935, effective on its publication on September 26, 1935, and as amended by Chapter 552, Laws of Wisconsin of 1935, effective on its passage and publication on October 8, 1935, and by Chapter 233, Laws of Wisconsin of 1937, effective June 14, 1937, is as follows:

"Section 3. Privilege Dividend Tax. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

"(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

"(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the

provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

"(5) Dividends paid by a subsidiary corporation to its parent shall not be subject to the tax herein imposed provided that the subsidiary and its parent report their income for taxation under the provisions of chapter 71 on a consolidated income return basis, or both corporations report separately.

"(6) The provisions of this section shall not apply to dividends declared and paid by a Wisconsin corporation out of its income which it has reported for taxation under the provisions of chapter 71, to the extent that the business of such corporation consists in the receipts of dividends from which a privilege dividend tax has been deducted and withheld and the distribution thereof to its stockholders.

"(7) For the purposes of this section, dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividends or liquidating dividends.

"(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

"(9) The tax hereby imposed shall, when collected by the tax commission, be paid by it into the state treasury.

"(10) Except as they are inconsistent with this section, the provisions of paragraph (b) of subsection (3) of section 71.06, sections 71.10 to 71.17, inclusive, subsection (3) of section 71.18, and sections 71.36 and 71.37 of the statutes shall apply to the tax imposed by this section, but the discount provisions

of paragraph (c) of subsection (3) of section 71.10 shall not apply.

"Section 4. SEPARABILITY CLAUSE. If any section, subsection, paragraph, provision or part of this act, or its application to any person or circumstance shall be held unconstitutional, such decision shall not affect the constitutionality of any other section, subsection, paragraph, provision or part, or its application to other persons or circumstances."

While originally this tax was operative only to July 1, 1937, it has been subsequently re-enacted in 1937, 1939, 1941 and 1943 by the following Acts of the Wisconsin legislature and is now operative:

(1) Section 37, Chapter 309 of the Laws of Wisconsin of 1937 (enacted and effective on its publication June 30, 1937) extended its operation to July 1, 1939.

(2) Section 1 of Chapter 198 of the Laws of Wisconsin of 1939 (enacted and effective on its publication on June 30, 1939) extended its operation to July 1, 1941, and also increased the rate from 2½% to 3% thereafter.

(3) Section 3 of Chapter 63 of the Laws of Wisconsin of 1941 (enacted and effective upon its publication April 30, 1941) extended its operation to July 1, 1943.

(4) Section 2 of Chapter 367 of the Laws of Wisconsin of 1943 (enacted and effective on its publication June 30, 1943) extended its operation to July 1, 1945 and also changed the purpose for which such taxes shall be used from general state expenditure, providing:

"• • • rehabilitation for returning veterans of World War II, construction of improvements at state institutions and other state property, and postwar public works projects to relieve postwar unemployment."

SUPREME COURT OF THE UNITED STATES.

Nos. 620, 621.—October Term, 1943.

620	International Harvester Company, Appellant, *vs.* Wisconsin Department of Taxation.	Appeals from the Supreme Court of the State of Wisconsin.
621	Minnesota Mining and Manufacturing Company, Appellant, *vs.* Wisconsin Department of Taxation.	

[May 29, 1944.]

Mr. Chief Justice Stone delivered the opinion of the Court.

These cases come here on appeal under § 237(a) of the Judicial Code, 28 U. S. C. § 344(a), from judgments of the Supreme Court of Wisconsin, reviewing and sustaining assessments by appellee, the Wisconsin Department of Taxation, of the Wisconsin Privilege Dividend Tax imposed with respect to appellants, which are foreign corporations doing business in Wisconsin. 243 Wis. 198; 243 Wis. 211. The appellants present again, but in a new aspect, the substance of the question decided in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435. In that case we sustained the constitutionality, under the due process clause of the Fourteenth Amendment, of the Wisconsin Privilege Dividend Tax, § 3 of Ch. 505 of Wisconsin Laws of 1935 as amended by Ch. 552, Wisconsin Laws of 1935.[1] The tax is imposed with respect to both foreign and domestic corporations doing business within the state "for the privilege of declaring and receiving dividends" out of income derived from property located and business transacted in the state. The payor corporation is required to deduct the tax from the dividends payable to both resident and non-resident stockholders.

Appellants are respectively a New Jersey and a Delaware corporation doing business in Wisconsin. Appellee has assessed the

[1] The statute was re-enacted by § 3 of ch. 309 of Wis. Laws of 1937; § 1 of ch. 198 of Wis. Laws of 1939; § 3 of ch. 63 of Wis. Laws of 1941; and §2 of ch. 367 of Wis. Laws of 1943.

Privilege Dividend Tax with respect to dividends declared and paid by appellant Harvester Company to its stockholders, including non-residents, between December 2, 1935 and October 15, 1937, inclusive, and on dividends similarly declared and paid by appellant Minnesota Mining Company in the years 1936 to 1940, inclusive. In the case of each appellant the tax as assessed was measured by so much of the dividends as were derived from the portion of the corporate surplus attributed by the tax authorities to income earned by the corporation in Wisconsin. The dividends were declared at directors' meetings held outside the state, and the dividend checks were drawn on bank accounts outside the state.

In the *Penney* case we sustained the tax in the case of a Delaware corporation doing business in Wisconsin, but having its principal office in New York, holding its meetings and voting its dividends there, and drawing its dividend checks on New York bank accounts. In considering the incidence of the tax in Wisconsin, which could afford a basis for the taxation there although the declaration and payment of the dividend took place outside the state, this Court pointed out that the practical operation of the tax is to impose an additional tax on corporate earnings within Wisconsin, but to postpone the liability for payment of the tax until such earnings are paid out in dividends, and we added, 311 U. S. at p. 442: "In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."

Since our decision in the *Penney* case, the Wisconsin Supreme Court has said, in both the *Penney* case on remand, 238 Wis. 69, 72-73, and in the *International Harvester* case below, 243 Wis. 198, 204-206, that under the Wisconsin constitution, the state has no power to lay an income tax on citizens of other states, who are not doing business in Wisconsin, and that the tax is not on the income of the corporation. And in *Wisconsin Gas Co.* v. *Wisconsin Dept. of Taxation*, 243 Wis. 216; cf. *Blied* v. *Wisconsin Foundry Company*, 243 Wis. 221, the Court held that the burden of the tax is imposed upon the stockholders so that the corporation is not entitled to deduct the privilege tax from gross income as a business expense, in arriving at net taxable income under the state's income tax law. In the *Wisconsin Gas Company* case, *supra*, the Court said, at p. 220-1:

"We are certain of three things: (1) That the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business [for state income tax purposes]; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case."

From this, appellants argue that the state court has now conclusively declared that the tax is not on income of the corporation, but only on the stockholders' privilege of receiving dividends, and that it must be deducted from the dividends before their payment to the stockholders. Appellants renew the contentions urged in the *Penney* case that since the declarations of the dividends here in question were made outside the state and the non-resident stockholders received their dividends outside the state, the taxing statute as applied in these cases infringes due process by imposing the tax on stockholders and on activities and objects outside the territory of the State of Wisconsin, and consequently outside its legislative jurisdiction. Compare *Connecticut General Ins. Co.* v. *Johnson*, 303 U. S. 77. To this is added the further argument, not presented in the *Penney* case, that the tax violates the Fourteenth Amendment because retroactively applied to and measured by Wisconsin income which was earned and carried to appellants' surplus accounts before the enactment of the statute.

For present purposes we assume that the statute, by directing deduction of the tax from declared dividends, distributes the tax burden among the stockholders differently than if the corporation had merely paid the tax from its treasury and that the tax is thus, in point of substance, laid upon and paid by the stockholders, some of whom might not bear the burden of the tax at all if, without more, it were paid out of the corporate treasury. This is obviously the case here with respect to the deductions from dividends on appellant Harvester's preferred stock, since normally the economic weight of taxes paid by the corporation would be borne by its common stockholders.

If such is the nature of the tax, a question preliminary to determining its validity is whether appellants have standing to urge here the constitutional objections of their stockholders, who are not parties to the present suits and who alone may be affected adversely by the tax. For appellants are permitted to reimburse themselves for the amounts, which they must pay to the state, by

appropriate deductions from the dividends belonging to the stockholders. Appellants' failure in these cases to make the deductions was by their own choice and not by compulsion of the statute. But as the only way by which appellants can avoid the payment of the tax from their own funds is by collecting it from their stockholders' dividends and as appellants would remain liable to the stockholders, certainly to the preferred stockholders, for the amounts to the deductions if not lawfully taken, they are, in either aspect, adversely affected by obedience to the statute, if it is unconstitutional. We therefore conclude that appellants have standing to challenge the constitutionality of the statute. Cf. *Anderson National Bank* v. *Luckett*, 321 U. S. 233, 242-3.

For the reasons stated in the *Penney* case we do not doubt that a state has constitutional power to make a levy upon a corporation, measured by so much of its earnings from within the state as it distributes in dividends, and to make the taxable event the corporation's relinquishment of the earnings to its stockholders. That power is not diminished or altered by the fact that the state courts, for purposes of their own, denominate the levy a tax on the privilege of declaring and receiving dividends, or that they decline to call it an income tax. In determining whether a tax is within the state's constitutional power, we look to the incidence of the tax and its practical operation, and not its characterization by state courts. *Shaffer* v. *Carter*, 252 U. S. 37, 55 and cases cited; *Lawrence* v. *State Tax Commission*, 286 U. S. 276, 280 and cases cited.

Nor do we perceive any constitutional obstacle either to the state's distributing the burden of the tax ratably among the stockholders, as the ultimate beneficiaries of the corporation's activities within the state, and of the state's relinquishment of control over the Wisconsin earnings, so as to render the tax *pro tanto* one on the stockholders' income, or to the state's imposing on the corporation the duty of acting as its agent for the collection of the tax, by requiring deduction of the tax from earnings distributed as dividends.

The power to tax the corporation's earnings includes the power to postpone the tax until the distribution of those earnings, and to measure it by the amounts distributed. Compare *Curry* v. *McCanless*, 307 U. S. 357, 370. In taxing such distributions, Wisconsin may impose the burden of the tax either upon the corporation or upon the stockholders who derive the ultimate benefit

from the corporation's Wisconsin activities. Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers. Compare *Shaffer* v. *Carter, supra,* and *Travis* v. *Yale & Towne Mfg. Co.,* 252 U. S. 60, with *Lawrence* v. *State Tax Commission, supra,* and *New York ex rel. Cohn* v. *Graves,* 300 U. S. 308. And the privilege of receiving dividends derived from corporate activities within the state can have no greater immunity than the privilege of receiving any other income from sources located there.

We think that Wisconsin may constitutionally tax the Wisconsin earnings distributed as dividends to the stockholders. It has afforded protection and benefits to appellant's corporate activities and transactions within the state. These activities have given rise to the dividend income of appellants' stockholders and this income fairly measures the benefits they have derived from these Wisconsin activities. There is no contention here that the formula of apportionment does not fairly reflect the proper proportion of appellants' earnings attributable to their Wisconsin activities and transactions. Wisconsin may impose a measure of control upon the corporation there with respect to its withdrawal of its earnings from the state, and also may, for the protection of the interests of the state and of its citizens, regulate to some extent the declaration and distribution of dividends by a foreign corporation, certainly with respect to its Wisconsin earnings. See, e.g., Judge Cardozo in *German-American Coffee Co.* v. *Diehl,* 216 N. Y. 57; New York Stock Corporation Law, § 114. The earnings in Wisconsin, their withdrawal from Wisconsin and their distribution in the form of dividends have resulted in the receipt of income by the stockholder-taxpayers and it is Wisconsin's relation to all which permits it to levy the tax. It may condition the privilege of earning and disposing of the Wisconsin earnings upon the payment of a tax measured by and collected from the earnings to be distributed as dividends. *Wisconsin* v. *J. C. Penney Co., supra.*

The facts that Wisconsin cannot prevent the withdrawal of the earnings from the state or the declaration of the dividends, if they be the facts, have no bearing on its right to measure, in terms of taxes, both the benefits which it has conferred on the stockholders in their relations with the state, and the activities or transactions which are within the reach of its regulatory power. *Equitable Life Society* v. *Pennsylvania*, 238 U. S. 143, 147; cf. Mr. Justice Holmes dissenting in *Compania de Tabacos* v. *Collector*, 275 U. S. 87, 99, 100.

That the distribution of Wisconsin earnings was effected by the exercise outside Wisconsin of the power to declare dividends does not deprive it of its power to take toll from the income earned there upon its distribution to the stockholders. See *Bullen* v. *Wisconsin*, 240 U. S. 625; *Curry* v. *McCanless*, *supra*, 366-370 and cases cited; *Graves* v. *Elliott*, 307 U. S. 383; *State Tax Commission* v. *Aldrich*, 316 U. S. 174, 180. And the fact that the stockholder-taxpayers never enter Wisconsin and are not represented in the Wisconsin legislature[2] cannot deprive it of its jurisdiction to tax. It has never been thought that residence within a state or country is a *sine qua non* of the power to tax. Cf. *Cook* v. *Tait*, 265 U. S. 47. So long as the earnings actually arise there, and their withdrawal from the state and ultimate distribution, in whole or in part, to stockholders are subject to some state control, the conditions of state power to tax are satisfied, see *Shaffer* v. *Carter*, *supra*, 55; *State Tax Commission* v. *Aldrich*, *supra*; compare *McCulloch* v. *Maryland*, 4 Wheat. 316, 429, even though some practically effective device be necessary in order to enable the state to collect its tax—here by imposing on the corporation the duty to withhold the tax on so much of the earnings withdrawn from the state as may be distributed in dividends. Imposition of this requirement on the corporation transgresses no constitutional limitations. *Nelson* v. *Sears, Roebuck & Co.*, 312 U. S. 359, 364; *Nelson* v. *Montgomery Ward & Co.*, 312 U. S. 373.

Appellants press with vigor, as controlling decision here, the denial of the state's power to tax in *Connecticut General Ins. Co.*

[2] The Wisconsin Privilege Dividend Tax does not discriminate against non-residents or foreign corporations, or place an undue burden on them without a corresponding burden on residents or domestic corporations. Hence this is not a case where "legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state". See South Carolina Highway Dept. v. Barnwell Bros., 303 U. S. 117, 184-5, n. 2 and cases cited.

v. *Johnson, supra.* In that case California sought to levy a tax on gross receipts derived from contracts made and to be performed in Connecticut by a Connecticut corporation doing other business in California. But as we said of the *Johnson* case in the *Penney* case, *supra*, 446: "In the precise circumstances presented by the record it was found that the tax neither in its measure nor in its incidence was related to California transactions. Here, on the contrary, the incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible, . . ." and both the earnings and their disposition are subject to state control and hence its power to tax.

It should be emphasized once again that the Fourteenth Amendment does not in terms or in effect prohibit unwise taxes, merely because they are unwise, or unfair or burdensome taxes, merely because they are unfair or burdensome. The wisdom or fairness of the tax before us are not matters subject to our control or revision. We are only concerned with the power of the state to lay the tax. The power to tax "is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation; . . ." *McCulloch* v. *Maryland, supra*, 429; *Curry* v. *McCanless, supra*, 366.

We conclude that appellants' stockholders can have no constitutional objection to the withholding by Wisconsin of a tax measured by their dividends distributed from Wisconsin earnings.

Appellants do not deny that the dividends are derived from earnings from within the state of Wisconsin, but it is urged that some of them at least were paid from corporate surplus earned and set aside in years before the taxing statute was enacted. But since the taxable event, the distribution of dividends paid from earnings, and the deduction of the tax from them occurred subsequent to the enactment of the taxing statute, no question of its retroactive application is involved.

The contention of appellant, the Harvester Company, that the formula for assessing the tax is not one authorized by the statute is not open to consideration here. The State Supreme Court has construed and applied the statute and by its construction we are bound. *Oklahoma* v. *Wells, Fargo & Co.*, 223 U. S. 298 and *Davis* v. *Wallace*, 257 U. S. 478, on which appellant relies, were cases

coming here from the lower federal courts, in which this Court was required to place its own construction on a state statute which had not been definitively construed by the state courts.

Affirmed.

Mr. Justice ROBERTS took no part in the consideration or decision of these cases.

Mr. Justice JACKSON, dissenting.

The facts of one of these cases will make clear the grounds upon which I dissent.

The International Harvester Company is incorporated under the laws of New Jersey. Its head business office is in Chicago, Illinois. It has qualified and has been admitted to do business in Wisconsin and in every state in the Union except Nevada. It has sales branches and manufacturing plants in Wisconsin, and in many other states. Proceeds of sales and receipts from operations in Wisconsin and in every other state are sent to the corporation treasury in Chicago and commingled in general funds without segregation or earmarking as to state of origin.

More than 32,000 stockholders are owners of this enterprise. They are domiciled in every state of the Union, less than 2 per cent of them in Wisconsin. Under the corporation's charter and the applicable law of New Jersey the stockholders may be paid dividends only from its surplus or net profits. Every corporate act connected with payment of dividends takes place in Chicago. There the directors meet to declare them, there the checks are drawn and mailed. They are paid out of the corporation's general funds on deposit in Chicago or New York.

In 1935 Wisconsin enacted a "Privilege Dividend Tax." It provides, with exceptions not material:

"Section 3. Privilege Dividend Tax. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to 3 per cent of the amount of such dividends declared and paid by all corporations (foreign and local). . . . Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

"(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. . . ." Wis. Stat. (1941) § 71.60.

Under this last provision the State by formula not now important apportions among the states the surplus from which dividends may be paid and thus determines a proportion of the dividend attributable to earnings in Wisconsin. As applied and sustained in this case, the short of the matter is this: Wisconsin says it may tax 32,000 stockholders, 98 per cent of whom reside in other states. It taxes them when and because they receive a dividend from a corporation not in its internal affairs subject to its laws, by acts not one of which is performed within its borders.

After the Supreme Court of Wisconsin held this tax invalid it was reinstated by this Court. *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435. This was done on the theory that the tax was not what Wisconsin called it but was in substance an income tax on the corporation, deferred until the income was distributed and measured by the amount of the distribution. As so interpreted, it was the federal undistributed profits tax in reverse; it was a distributed profits tax. But the Wisconsin court has respectfully but firmly insisted that it knows whom Wisconsin is taxing and why. It says this is not an income tax, that it is no tax on the corporation, but is a tax on the stockholder when and because he receives a dividend.

I think the parties are entitled to have the constitutionality of this far-reaching tax decided on the assumption that it is just what the Wisconsin Legislature and Supreme Court say it is. If we do, the question is whether a state may tax nonresident stockholders for receiving from a foreign corporation a dividend from its surplus or undivided profits merely because some time in the past a portion of the surplus was earned in the state.

We must put out of consideration entirely reasoning by which we sustain state taxation of income of the corporation. These dividends are not and cannot be regarded as income of the corporation within any legal or accounting definition. These surplus funds constituted income once—at the moment of receipt—and

may be counted as income for any period which includes time of receipt. But once received, they became capital funds in the sense that earned surplus becomes capital. When they were distributed they were not income of the corporation. They were its surplus capital funds. Not even the power of this Court can make income of outgo. To speak of "a tax on corporate income that is paid out" is as self-contradictory as to speak of round squares.

These dividends of course are income to the stockholder, and any state with jurisdiction to tax him may tax them as such. But I am unable to agree that having "afforded protection and benefits" to a corporation gives jurisdiction to tax the incomes of all its stockholders. Nor do I think that because the state has once permitted the corporation to do business and make earnings in the state its taxing power follows those earnings into the hands of third persons to whom they may be paid. A dividend when declared becomes a debt of the corporation, enforceable as any other debt. If there is power in Wisconsin, because funds were earned there, to tax the receipt of a dividend, there is no reason why it should not also have power to tax the recipients of corporate funds as wages, salaries, or as payment of any other obligation.

Moreover, the Court itself apparently feels obliged to abandon the income-tax-on-the-corporation theory in order to avoid the objection of retroactivity. In considering this aspect of the tax it shifts to a "taxable event" theory which places the event after the enactment of the statute.

I also find it difficult to accept the statement that there is no "constitutional obstacle either to the state's distributing the burden of the tax ratably among the stockholders . . . or to the state's imposing on the corporation the duty of acting as its agent for the collection of the tax' . . . ." The relations between different classes of stockholders is fixed by the corporate charter. If this is a tax on the corporation, it is clear that its burden falls upon the equity stockholders and upon them alone. I do not think the State of Wisconsin would have the power to provide that the preferred stockholders of a New Jersey corporation, despite provisions of its charter, should assume a part of the equity burden.

As supporting this tax, the opinion of the Court says that Wisconsin may impose upon the corporation "a measure of control

. . . with respect to its withdrawal" of these earnings, and that their "ultimate distribution . . . to stockholders" is "subject to some state control." I do not understand to what reference is made. These earnings lawfully had been added to surplus of a New Jersey corporation, they were represented by funds lawfully transferred to Chicago or New York. From them the corporation made the distribution. What control Wisconsin had over these funds in these circumstances I do not see.

The act in question does not purport to be one for the protection of local creditors against the corporation's illegal payment of dividends as was the act dealt with by Judge Cardozo in *German-American Coffee Co.* v. *Diehl*, 216 N. Y. 57. This act alters the purely internal relations of different classes of stockholders without in the least affecting their relation to creditors.

It is impossible to reconcile the taxable-event theory with the benefit theory for supporting this tax. The taxable event clearly is the payment of the dividend. The right to make such payment is not derived from Wisconsin law. The ability to do so does not depend on Wisconsin earnings. The existence of earnings for the period, or of an accumulated surplus, from Wisconsin earnings alone would not authorize such a dividend. That would depend on net accumulations from all sources and surplus from Wisconsin might be neutralized by losses from operations elsewhere. In such a case it is clear this statute would not even purport to tax, although Wisconsin had extended exactly the same protection to the operations within the state as otherwise. Moreover, if earnings were had in Wisconsin and there were net earnings overall but the corporation should decide to accumulate them, the statute would not purport to lay the Wisconsin tax. These facts make clear that Wisconsin is doing what the Supreme Court of Wisconsin said it was doing. It lays a tax upon the stockholder's dividend. It does not tax the income of the corporation.

I do not see that the way to tax the dividends of nonresident stockholders can be bridged by "some practically effective device" necessary "in order to enable the state to collect its tax—here by imposing on the corporation the duty to withhold the tax." Do we mean that the state may empower or obligate a foreign corporation to collect for it taxes it is without power to collect itself? The physical power to get the money does not seem to me a test of the right to tax. Might does not make right

even in taxation. To hold that what the use of official authority may get the state may keep, and that if it cannot get hold of a nonresident stockholder it may hold the company as hostage for him, is strange constitutional doctrine to me.

Whatever rights Wisconsin has to reach beyond its borders and tax nonresidents every other state has also. One who puts his savings to work in an enterprise of national scope may be subjected to any number of state taxes on his dividends up to forty-eight. Any number up to forty-seven of them may be levied by states in which he never lived, never went, did no individual business, and has no vote. Representation is the ordinary guaranty of fairness in taxation.

I do not think any fact in this case shows jurisdiction in Wisconsin to lay a tax on a privilege she does not grant and could not deny, which is exercised wholly outside of her borders and by those who are not her citizens or her corporate creatures. I see no foundation for the tax Wisconsin has laid and no better foundation for the substitute tax this Court has laid. I would reverse the judgments below.